PITMAN'S "ART AND LIFE" SERIES

General Editor: WRIGHT WATTS MILLER, B.A. Lond., M.Ed. Man.

Late Campbell Clarke Scholar, University College, London
Lecturer at Borough Road Training College

ECONOMICS

THE "ART AND LIFE" SERIES

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1. ECONOMICS : The Study of Wealth

A. L. GORDON MACKAY, M.Litt., M.A., M.Econ., author of *The Australian Banking and Credit System* and *Experiments in Educational Self-Government.*

2. ARCHITECTURE : A New World

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THE INTELLIGENT TRAVELLER

DOMESTIC ARTS

PSYCHOLOGY

FOREIGN AFFAIRS

WRITING AND SPEAKING

ECONOMICS

THE STUDY OF WEALTH

BY

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AUTHOR OF
"THE AUSTRALIAN BANKING AND CREDIT SYSTEM" AND "EXPERIMENTS IN EDUCATIONAL SELF-GOVERNMENT"

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TO

HENRY J. MacKAY

IN RECOGNITION

OF MUCH KINDNESS

PRINTED IN GREAT BRITAIN
AT THE PITMAN PRESS, BATH

MR. A. L. GORDON MACKAY was born in Australia and educated at the University of Sydney and Trinity College, Cambridge. He served with the Australian Imperial Force during the War, and won the D.C.M. at Peronne. From 1925 to 1928 he was Lecturer in Economics and Director of Tutorial Classes at the University of Adelaide. During 1929 and 1930 he held a Rockefeller Fellowship at Trinity College, Cambridge. He is the author of two books: *The Australian Banking and Credit System* and *Experiments in Educational Self-Government*. During the last two years he has visited France, Germany, Czechoslovakia, Austria, and Italy, in order to make a special study of central banking and of the departments of economics in the ten major Universities of Europe.

SPECIAL NOTE TO THIS VOLUME

THE "Art and Life" Series is a series of books for adult readers who are indulging in the pleasure of self-improvement, or who wish to extend their appreciation of such things as pictures, architecture, books, plays, and films. This volume is an entirely self-contained introduction to economics; the author's preface explains its scope in a few words. It *can* be read without reading the General Introduction at all, this being mainly concerned with subjects commonly referred to as "the arts"; nevertheless, this Introduction recommends the study of economics very strongly to those whose primary interest is in the arts; the student of economics, for his part, may also be interested to see the fundamental connection between the science (or is it the art?) of economics and the arts of writing, building, drawing, etc., which is insisted on therein.

W. W. MILLER.

"Every man is in his own way an artist, because every man at some time or another has had those strange experiences which have nothing to do with the business of daily life. The mathematician, the biologist, the grocer, the clerk, the painter, the musician, the poet, all at some time or another, in the midst of what is merely a mechanical functioning, and habit of work, have had moments which came like a flash, when something hidden in them was about to change. Suddenly a sense of life! Art is only a sense of life at the instant of creation. But infinite are the things created—multifarious and intangible and imponderable! Do not let us think of those things only as created which are locked up in a few physical and intellectual appearances. The clerk who has never written a sonnet, or painted a picture, or begotten a child, is yet not empty and devoid of creation. For he may create himself, and he may create through the mind and body of another, since he may be the cause and the occasion of creation in some other soul. Therefore, the artist will not puff himself up but will be humble, for he is among his brothers always."

W. J. TURNER
(*The Aesthetes*)

"As we live, we are transmitters of life.
"And when we fail to transmit life, life fails to flow through us."

D. H. LAWRENCE
(*Pansies*)

GENERAL INTRODUCTION TO THE SERIES

"How much do we get out of life?"

It is a familiar question. The "Art and Life" Series asks it once more, and tries to suggest how it may be answered with more and more satisfaction and pleasure. The books in this series are not meant to be packets of facts to remember (though facts, we hope, are there in plenty), but guides, suggestions, and stimulants. Their purpose may sound a big one, stated simply, but many simple statements must sound big.

What the "Art and Life" Series proposes to us is *the adventure of seeing what we did not see before.* It offers the very inexpensive and lasting pleasure of widening our interest in, and our appreciation of, things which are almost constantly part of our surroundings.

No. 1 of the series is *Economics*, about which we shall say a word later. The other five of the present first issue deal with *Architecture, Literature, Art* (that is, painting, drawing, and sculpture), *The Theatre*, and *The Cinema*—five of what are commonly called "the arts."

What do we mean by "the arts"? "Art," says the dictionary, is "skill," or "the acquirement of skill"; "science" is "knowledge," or "the pursuit of knowledge." Which would any of us rather acquire—knowledge of something, or skill in doing something, skill, that is, in using knowledge? We cannot do without the "knowledge"—there is little "knowledge" that may not be

useful to us—it is "interesting," we say, to acquire knowledge. But skill involves our own selves so much more; skill implies a power to exercise our knowledge, to exercise all our powers, to do, to go on doing, and never to cease improving or to grow tired of trying to improve. The most accessible kind of skill for most of us to acquire nowadays is in sport and games; the fun is in the exercise, not in sitting down to acquire the "knowledge," if we are learning to bowl breaks, to lob at tennis, to climb a precipice or tune up a two-stroke. Besides playing games, all of us read, nearly all of us go to the cinema, and, when we can, to the theatre, and every one of us is inescapably beset by architecture and by decorative art, of sorts, every day. What have these, you may say, to do with "skill"? Reading and going to the cinema or theatre are amusements, ways of passing the time—too much of them could be very bad for us; the "skill" in these things, is it not for the fortunate and enviable few, the writers and actors and playwrights, the architects and working artists?

But there are two sides to every work of art—every book, every well-written newspaper or advertisement, every play or film, every public building, every petrol station, chair, table, or poster—the two aspects of creation and appreciation, and these two, of course, are inseparable. The purpose of the "Art and Life" Series is to show the *skill*, the unending and increasing pleasure of cultivating appreciation, or "taste." But it is by no means implied that creation is, therefore, the business of the few. Appreciation is itself a creative act—it demands a good, a trained appreciator. The training is mainly

self-training, and limits to this training simply do not exist.

To "appreciate" a work fully one must go through something of the processes—the *creative* processes—which the artist went through in creating it. The word "appreciation" does not just mean "liking a thing," any more than "criticism" just means "finding fault with it." There is no single word to replace the word "appreciation"; it does not mean merely "understanding"—that refers to the intellect only; it means more than just observing or noticing or being pleasantly affected by a thing; it means getting as it were inside the skin of the poem, the painting, the piece of furniture or whatever it is to be appreciated, and *realizing* the thing in every possible way. We use the word rightly when we speak of appreciating good food and drink; anyone can *like* any sort of food if he is hungry enough, but to *appreciate* it implies knowing delicate tastes from coarse, and knowing the value of the difference between one sort of taste and another. It is very significant that we use the word "taste"—the delicate savouring of something with the tip of the tongue against the palate—to mean also the savouring of all that is most exquisitely and vividly made in pictures, in books, in music, in good manners and conversation, in dress, in pottery and furniture—all the things in which we can display "good taste" or "bad taste." The poor Arab, we are told, has no taste to speak of; he cannot resist the stimulation of eating red peppers; he eats them until he is ill, and then has to take to an equally unbalanced diet of milk until he is better, when back he goes to peppers again. It is similarly

easy for us to become mentally and spiritually ill through neglecting our powers of "taste," or through having someone else's bad taste forced upon us—red wall-paper, for example, instead of red peppers. Or we may become weighed down, without realizing it, by the pretentious, heavily-ornamented architecture of the room where we work; ill-assorted, exaggerated decoration gives no respite to the eyes or nerves, and will not leave us to get on in peace with the work for which the room was intended.

The beauty of cultivating appreciation is that it implies, first, knowledge—there is always some more to be learned—but that the knowledge is useless to us without our cultivating the right attitude and *assimilating* the knowledge. You see a joke in *Punch*, for instance, which depends upon the word "stymie." You know nothing whatever about golf, and you have to ask some golfer to explain to you that a stymie is not a kind of club but a situation. You "see" the joke, in a sort of way, but you will probably also say that you "see" nothing in it—you do not *appreciate* it. The next time you see a joke depending on the same word, you "see" it more quickly, but it will probably be a long time before the word "stymie" has sunk into your vocabulary so that you can instantly *appreciate* its use as if you were yourself a golfer. If you have a fanatical prejudice against golf you will never be able to see a golf joke, and your powers of appreciation will be so much the poorer for want of exercise.

The example of the stymie illustrates the whole business of "the arts." "Art," says Mr. Galsworthy, "is the one form of human energy which really works for union

and destroys the barriers between man and man. It is the continual, unconscious replacement of one self by another." The arts are the interpreters between ancient Greek and modern Englishman, between inscrutable Man and inscrutable Woman, between white men and coloured men, between serene old greybeards and fire-eating youngsters. The arts are interpreting to you all the time; not oniy because they bring you the life of people and places which you could never see, but because they illuminate with fresh light—"the light that never was on sea or land"—your daily experience as well as your wildest adventures. The arts are all ways of *talking* to one another ("communicating" is the word we should use, but it has not the same life as "talk")—of preserving the most profound, most ecstatic, most amusing, most moving of our experiences, ideas, fancies, discoveries, arguments, dreams, complaints, shouts of joy, for each other and for those who come after us.

The arts, along with our laws, our institutions, and our healthy citizens, are the stuff of what we call civilization. A "civilized" person means one who is fit to live among his fellows in a *civis* or state. He must know how to behave—there is an *art* in good manners; to know the rules, we say, is not enough—personal "skill" and good taste are needed to apply the rules. The good citizen or citizeness will dress, too, at least so as to avoid giving offence to others, and probably—the citizeness, at least—so as to give genuine pleasure to others as well as herself. Is there, indeed, a more flourishing and genuinely appreciated *art* than the art of dress?

To sum up these examples: we believe most strongly,

in this series of books, that "the arts" are not the exclusive business of a few gifted persons, with the rest of the world left only to stand and gape. (The admirable words of Mr. W. J. Turner on the same subject have been purposely chosen to stand at the head of each volume of the series.) The idea of this series is to present as many facets as possible of the approach to the arts, as many stimulations to appreciation as possible, and some explanations of difficulties which the authors have found, in their teaching experience, to be the commonest barriers to enjoyment. For the rest, we want by bibliographies and lists to send the reader to other people's books for enjoyment, to the galleries where the pictures are, the theatres and cinemas where the plays and films are, and the streets where the buildings are. This is not exactly a series of "textbooks" in the ordinary sense; particularly it is not a series of *histories* of literature, painting, etc. The historical point of view is the one point of view that does demand immense preliminary knowledge before it can be made interesting, and we regard it as calamitous that so many lecture-courses should adopt the historical point of view. If one really likes books or paintings, one will find out for oneself, one will learn almost unconsciously, their history and their order. But one has first to like them, to feel that they have really something to say that can be said in no other way.

We would like to insist on one technical point only in this general introduction: each of the arts must be allowed to stand on its own feet; what may be excellent in the theatre, for instance, may very well be useless in

the cinema, in the way that a good tennis stroke is usually a hopeless stroke for cricket. The cinema must be judged by its own standards as an art of motion, of gesture, and of sound; Mr. Andrew Buchanan, who has been producing a fresh film every week for the last five years, has undertaken to explain those standards in his book on *The Films* for this series, and Mr. Nugent Monck, who has directed the Maddermarket Theatre, Norwich, since its foundation, insists, in *The Playhouse*, on the different standards of the theatre. Or, again, in reading poetry, one may be pleased by its "musical" qualities, yet poetry is not music and is not to be judged by the standards of music. If we are to get the best out of Mr. Raymond Coxon's book on Art (the fruit of many years' teaching of all sorts of audiences), we must be prepared to allow painting to fix *its* own standards; if we are trying to appreciate a striking painting of a kitchen chair by Van Gogh, for instance, we must acknowledge that it is a *painting* (which, incidentally, appears to be based upon a kitchen chair), and not a kitchen chair itself, that we are trying to appreciate. Most of all in architecture, I believe, is it necessary to grant that the subject must have its own point of view. The author of the book on Architecture in this series is Mr. Raymond McGrath, who has designed several fascinating and strikingly modern houses and taken a principal share in the decoration of the B.B.C. building in Langham Place. Mr. McGrath points out the profound effect that the shapes and lines and colours of our streets, our buildings, our houses and our homes must have upon us continually; he tries to show how important it is—

and how much more pleasing—that architecture should have its own standards, that the plain four-square shape of the simplest kind of building, for instance, should not be marred for us by the builder's sentimental liking for a design which is only suitable to something the size of the British Museum or the Capitol at Washington.

All the authors in this series have previously written with enthusiasm about their subject, in periodicals, and some of them in books. Almost all of them have had considerable experience of teaching their subject to adult, interested audiences, who were not preparing for examinations. But what is most in their favour is that all of them, when first approached, confessed that they already had in their heads some idea of writing a book on the lines which they have followed in their work for this series. The "Art and Life" Series, in short, more or less created itself.

The initial idea of the series came to me in lecturing to the Workers' Educational Association[1] in Lancashire;

[1] I should like to say a word about evening classes to those who may know them only by name. In England and Wales there are one hundred thousand adult persons attending voluntary, non-vocational classes in economics, literature, the drama, art, music, languages, philosophy, psychology, history, Greek dancing, country dancing, handicrafts, and other subjects. (This figure excludes all classes organized for any technical, religious, or political purpose.) The students go purely for their own pleasure or interest in the subject; they pay a small fee (rarely no fee), and they take no examination, unless they like to set themselves a test of their progress. They meet at summer schools as well as in classes, they take trips abroad and rambles at home; their dramatic teams enter for the British Drama League competitions, and their choirs, orchestras, and dancers compete at festivals. The tutors of these classes are, naturally, for the most part professional teachers, but other persons are not excluded, and there is no room for the pedagogue; the classes are co-operative affairs of discussion and investigation, and the demand for any particular class almost always comes in the first place from would-be students, who

it developed in the course of work with the L.C.C. Literary Institutes in London and with students in training as teachers, and was discussed with artists and journalists who are earning their living by work for the commercial and general public. Among all these persons, *except the professional artists and writers,* I found a very common conception, the existence of which is corroborated by other teachers and lecturers, that "the arts," although "interesting" enough and even absorbing for leisure hours, are bound to take a back seat and eventually die out, as superfluous ornaments, in our present *mechanized* civilization.

The authors of the "Art and Life" Series believe most strongly that this misconception is one of the largest barriers, perhaps the principal barrier, to general enjoyment of the arts to-day. We believe that it is of the highest importance that we should try to answer and dispose of that conception here and now. We believe that the word "mechanized" does not cover the whole of life

often suggest to the tutor modifications of the course as they find their needs change. Most of the classes outside London (and some in it) are organized by the Workers' Educational Association and the Extension Boards of the Universities: in London, they are found mainly in the London County Council Literary Evening Institutes. Distinguished lecturers, from the Poet Laureate downwards, visit most of the centres at least once a year, and in London weekly or even more often. The City Literary Institute, in Goldsmith Street, Drury Lane, with its café, library, theatre, and student dances, is more like a club than a school; the general purpose of the Literary Institutes, in their own words, "is not the acquirement of textbook knowledge. The student desires rather to pursue those inquiries which promise *to make his life fuller.*" The most vivid testimony I have heard to these classes was the perhaps slightly exaggerated, but tremendously sincere and significant, phrase of a weaver from Nelson, Lancashire, who was urging W.E.A. classes upon some younger men: they asked him what classes he went to himself: "Not now," he said. "I'm past classes now. I've learned how to *live*!"

to-day; that if we do live in a considerably mechanized age then that is our good fortune; that the machines, not only those of iron and steel, but the subtler ones of organization and human routine, the "machines" that give us the guaranteed wage and standardized working conditions, are there for our service and not our enslavement, and that if we find many things that should never have been mechanical are becoming so, that is largely our own fault. If you *will* turn on the wireless instead of practising on your own second-hand fiddle, whose fault is that? If you are content to buy the ready-made, standardized hen-house instead of building one yourself, if you are content to soak yourself in a magazine instead of stirring your own wits to write an *interesting* letter to the cousin in Australia for once, whose fault is that again?

But the mere fact that you are reading this proves that you are not one of those whose ideal existence is defined as nearly as possible as "sitting in an arm-chair and pressing a few buttons." There are not nearly so many of the button-pushers about as you might think, and, apart from brief spells—we could all enjoy a single week's holiday, button-pushing—they are not anything like so happy as you may be thinking; they are probably not happy at all. Yet in your rejection of their mechanical comforts you need not hanker after some earlier "un-mechanized" stage of civilization; if you do you are hankering after an earlier age without the comforts of modern plumbing, the geyser, the vacuum cleaner, of lighted streets and shops and clubs, of centrally heated cinemas and music halls, without the pleasures of music

from the ether and books from the library, or the pleasure of dressing *like* other people, in the flattering fashion, and yet not *quite* like, with a thousand shades and patterns of mass-produced fabrics to choose from.

It is obviously to our "mechanized" civilization that we owe these comforts, these reliefs from anxieties and menial duties. And what is the result of the liberation they afford? The actual fact is that there were probably never before so many persons anxious to understand the world in which they live, to squeeze for themselves some share of individual living from all it has to offer, probably never so many persons striving, they would say, to "express themselves." And we "express ourselves" not only in drawing or singing or dancing or writing (if it is only in writing letters), but, much more significantly, in our relationships to each other, in our talk, in our understanding of each other, and in our own particular version of good manners. The well-established "standardization" of good manners, indeed—do we not find that that has faded away to a shadow of its former self even during our own lifetime? We assume, as a rule, nowadays, that people know in their hearts how to avoid giving offence, and that the rules of behaviour need be few and simple; we leave more to the individual, and so society becomes more interesting. It is thus in our own hands to make right use of the freedom and the mixing-together which mechanical civilization has afforded us by standardizing *certain* of our activities.

The arts flourish where commerce flourishes; they flourish in our modern civilization. Among all the persons I quoted just now, the professional artists alone,

I said, were neither pessimistic nor sceptical about the position of the arts in these days. The artist is a practical person; his work is "nine-tenths perspiration and one-tenth inspiration"; he is designing all around us petrol pumps (*someone* must design them) and cinemas and garages; his insidiously-chosen words lure us in the advertisement columns as well as in the novels and the poetry that we read; he is working in the cinema, too, and fighting hard for our attention. Had you realized that when you were enjoying Charlie Chaplin in that peculiarly "mechanized" institution, the cinema, you were enjoying the expression of a completely new *art* of gesture? Or some other of you, perhaps, who will not admit the despised cinema among your "artistic" interests—might it be asked how much trouble you took to see two Russian films called "Turksib," and "The End of St. Petersburg," or "The Italian Straw Hat" from France, or "Berlin" and "The Girl in the Moon" from Germany, or an English film with the commonplace title of "Murder"?[1] If you have seen none of these and you are a person of any artistic sensibility, there is a new world of revelation awaiting you.

You may rightly complain that the average film, the average petrol pump or garage, is anything but an artistic triumph, but the remedy is surely to a great degree in your own hands in these days when commerce, outside the field of necessaries, asks nothing better than to "give the public what it wants." What the artist himself needs, more than sales of 100,000 copies or fabulous prices paid

[1] The cinema, of course, is developing so fast that these examples are soon bound to "date." They are some of the films acknowledged best up to June, 1931.

by connoisseurs, is a genuine, warmly appreciative audience. If he does not find it he cannot do his best work; he does not work by himself in a kind of vacuum; his work is bound to bear the mark of his own generation, and his work, by which his generation will be remembered, in after time, when all their names but his have been forgotten, will nevertheless bear all their characteristics. It is in their own hands whether later history shall think well of them or not.

The last point, therefore, in this introduction, is that to all of us who have the faintest interest in the arts, the study of the workings of the industrial and commercial system which gives us our flourishing art to-day—in one word, economics—must be of the profoundest interest. That is why Mr. MacKay's book on economics has been made No. 1 of this Series. Mr. MacKay has spent most of the last six years lecturing on economics, and you will see, from his brief preface to the book, that he has no illusions about the difficulty of explaining the subject in a small space, even to a specially interested audience. He promises, however, that his reader should, at least, be able "to pick out fact from fancy in the daily Press." To those who have not hitherto been interested in economics we may suggest that it would be well to compare some of the "fact" with the "fancy," which, in this case, is often of the wildest imagination; but we will leave Mr. MacKay to point out the commonest fallacies, only repeating that one should be able to return from a study of economics, strengthened and enlightened, to one's original interests among "the arts" with a much deeper sense of their permanence in an era of "mechanized"

civilization. Looking the economic situation in the face may clarify instead of destroying one's "dreams."

And the earnest student of economics himself, the well-informed, possibly rather sardonic, "I-told-you-so" sort of person, who began with economics because it was a "practical" subject, and scorned the arts as mere idle graces of an effete civilization—may an adjustment of his position be suggested to him? Can all our political and economic reforms, our schemes with big names ending in "-ation,"—can they possibly be regarded as ends in themselves? Can they have any meaning if they do not lead to increased happiness and beauty in individual lives? It would be little use creating a Utopian economic system for a nation of scandalous morals, ape-like perceptions, and diseased bodies. An economic system is only one aspect of the arrangements which intelligent people come to so as to be able to live together; even if it were proved that an ideal economic system could establish the beginnings of an ideal society, it would not be the economic system that would enable that society to remain at its high level: the difficult business of living would only have begun for them when their economic security was assured. It may very well be that economic and political effort are of primary importance in any country which finds itself in the precarious situation which Europe has been getting used to during the last few years, but, as Mr. Ramsay MacDonald pointed out on one occasion, it would be fatal to assume that all pursuit of beauty or skill or fine living should, therefore, cease for the time being. If we dropped these pursuits we would by no means be able to take them up again

where we left off. The arts are not merely spare-time occupations; the artist is a worker like anyone else, and not a "highbrow." (Indeed there could be no better time than the present for driving the debased, battered, and by now almost meaningless word out of the language. We fling the word at anyone who talks about things we do not happen to understand, when we should reserve it for persons who arrogantly parade their knowledge.) The artist does not parade his superior knowledge or gifts; knowledge entitles no one to assume superiority unless to assert himself over a point of fact, and we can all put up with that. The artist is "superior" by his more intense power of living—artists, by the way, do generally live longer than most other people—and that power makes him more inclined to insist on his community with other people, if he is a true artist, than to insist on his distinction from them.

If you seek a justification for the arts you will surely find it in the memorable moments they can give—memorable over years, ecstatic as young love, or illuminating as a sudden shaft of sunlight: the way a book can re-create spring in your mind, or a blaze of music from an organ can lift you to delight, the excitement of a man standing and turning in his stirrups against the skyline at the cinema, the sense of pride and well-being at walking down a majestic avenue lined with trees and aspiring, beautifully-proportioned buildings. You would be wrong to think of these moments as small things; they were moments that you shared with others, and they were moments of communication from other persons to you. To conclude by repeating a phrase: the arts are all ways

of talking to one another—they are "the continual, unconscious replacement of one self by another"; they add to our "knowledge" and our experience. Knowledge drives out fear; it turns dislike into like a thousand times for once that it turns like into dislike. In our isolation from one another in this world, man from man or nation from nation, our first reaction to the unknown is generally dislike born of fear. But the keys of knowledge are in your hands; the driving out of mistrust, enmity, and fear is very much your responsibility.

WRIGHT WATTS MILLER.

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Mr. Raymond McGrath, who has designed all the covers for the series, and given much valuable general help.

Mr. W. J. Turner and his publishers, Messrs. Wishart & Co., for permission to quote the passage from *The Aesthetes,* which is given on page vii.

AUTHOR'S PREFACE

ALFRED MARSHALL, the former Professor of Economics at Cambridge, is reported to have said of small books on economics something to the effect that it is impossible to tell the truth for three and sixpence. This saying has been exercising my mind all the time I have been engaged in writing this volume. What Marshall probably meant was that it was impossible to tell the truth *comprehensively* for three and sixpence, or, for that matter, five shillings, and if this is what he meant, then I agree with him.

Readers can well understand how difficult a task it is to write economics simply, in such a way as to *avoid* giving readers and students the impression that the subject is easier than it really is. It has been my main object in the pages that follow to present the essentials of economics in a simple, straightforward manner, free from all technicalities, and at the same time to indicate, without beating about the bush, where the difficulties really do lie.

What are the economic problems that are foremost in the minds of men to-day? What do you hear being discussed by groups of men on the street corner, in the hotel parlour, in clubs, in Parliament, and even in fashionable drawing-rooms? It is unemployment, tariffs, the gold standard, and other aspects of the problems which arise from the mal-distribution of wealth.

All of these are very difficult problems to think about

or to discuss intelligently. They involve a wide knowledge of economic history, of the laws of economics, and of the development of economic theory. They are problems which men, possessing this knowledge, find it very difficult to discuss and even more difficult to reach agreement upon. So that it is no wonder that when Members of Parliament, working men, salary earners, and fashionable ladies turn their minds to a consideration of economics their ideas are muddled or their point of view one-sided.

In the days when the business of governing concerned only a very small section of the community, this ignorance of economics did not matter very much. Pitt could get the advice of Adam Smith, or Palmerston the advice of Ricardo, on the economic problems of the day, and then carry through any economic measures that were thought desirable.

To-day matters are changed. Almost every one has the vote and can express an opinion on economic problems; almost every one can read and can, in consequence, at least find out from the daily papers and magazines what is going on, while, since the War, the wireless has come into approximately four million homes in the British Isles, and into a proportionately great number of homes in the Dominions. This means that the womenfolk in the homes of the Empire hear the major problems of the day discussed by some authority almost every evening; so that to the increase in the number of men who are interested in economic affairs there is now added a very large number of women.

These changed circumstances have produced a condition of affairs that did not exist before the War. The

number of people who are interested in economics and in economic problems has been enormously increased; this is due to the extended voting facilities, to the upheaval in our ideas which has been caused by the War, and to the very hard economic conditions under which we are at present living. Then, in addition to an increase in the number of people interested in economic matters, there is an increase in the *methods* of getting at people so as to be able to influence their minds in special directions—a task that is fairly easy when one considers the low state of mental development that must exist in a nation that allows its compulsory school age to finish so early as fourteen. This attempt to control public opinion by presenting a case to untutored minds and to minds without a sense of discrimination has produced, since the War, a new danger—that of propaganda.

The only answer to the increase in the number of people interested in economic problems and to the increase in the methods of getting at people so as to be able to influence their minds in a special direction is to give them, at a low price and in simple language, the truth about the facts of economics, some insight into the elements of economic laws, and some practice in economic reasoning. The following pages represent an attempt to condense into a small space the essential things which a representative citizen should know about the economic life of the world in which he lives. In this book, no attempt to guide opinion is aimed at. In the simplest language that I can command, there are set down what I regard as the fundamental things in economics. It is conceived that, as a result of knowing these things, any one, who previously

knew nothing of economics, will better understand the major economic problems which confront us to-day, will be able to pick out fact from fancy in the daily press, and will be able to go on to a deeper study of the subject should he feel so disposed.

The final Chapter of this book, entitled "Makers of Modern Economics," is based upon my travels abroad during 1929 and 1930, and it is inserted so as to give readers some idea of the world's most important economists at the present moment and, at the same time, to indicate to what schools of economics they are attached. I know of no other book that has done this, and the attempt seemed to me to be well worth while.

For any expression of opinion found in this book, I alone am responsible. I should like to thank Mr. Miller, the General Editor of the Series, for some suggestions that he made about improving the method of presentation of the material contained in this volume.

A. L. GORDON MACKAY.

LANSDOWNE HOUSE,
DEVIZES, WILTS.
August, 1931.

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CHAPTER XVIII

CHAPTER XIX

ECONOMICS

CHAPTER I

THE NATURE AND SCOPE OF ECONOMICS

THERE are so many definitions of economics that any attempt to name and explain them would only puzzle the reader. It is sufficient to bear in mind that it deals with wealth in the best and broadest sense in which that term is used. Before a thing or an idea can become part of wealth it must possess three qualities, viz., it must be useful, it must be limited in quantity, and it must be external to man. Whether economics is concerned with morality or with ethics or whether it is a science like geometry is a matter which we can leave over until we know what is in the subject. Later we can, perhaps, make some attempt to give economics its proper place among the social sciences.

Economics as a Method of Thinking.

Some people say that economics, itself, is a method of thinking. There is much truth in this suggestion, even though what is meant by it is not clear. Certain it is that those who are economists or who have had an economic training have a way of thinking about the problems of the world and of life that mark them off from their fellow-beings. Nevertheless, economists use the methods for obtaining and handling their material which are

commonly used by thinkers in other realms of knowledge. These methods are the historical, the statistical, the inductive, and the deductive. Certain schools of economists place greater emphasis than others upon each of these methods, but a good economist has to understand and use all of these methods. Let us consider what these methods are. The historical method is that by which, if we want to know anything about something, we inquire into its origin and development, i.e. we want to know how it came about. The statistical method is mainly concerned with counting, with collecting material, with its proper arrangement, and with the task of drawing meaning from these facts; sometimes it is said that statistics can be made to prove anything; this is nonsense; it is only those who do not understand the statistical method who can be deceived by an unworthy use of it. Statistics are very important in economics and are becoming more so.

The Inductive and Deductive Methods.

The inductive and deductive methods are rather more difficult to understand, but because they naturally go together and arise out of each other we can try to understand them together. The simplest explanation that can be given of induction is to say that if one wanted to give a definition of a book, one would have to take, say, half a dozen books and compare them, abstracting the element that is common to all of them. For example, take their colour. Is this a common element? No. Is their shape? No. Is their thickness? No. Is the fact that they are printed a common factor? Yes, but all printed things are not books. We go on in this way till we have the element

that is common to books and not to anything else. This process is called induction. Deduction consists in taking this common element and using it as a test to decide whether objects are books or whether they are not.

The Assumptions of the Present Economic System.

The next thing upon which we need some information is the assumptions of the existing economic system as it is to-day. For the sake of simplicity these can be grouped under eight headings—

First, the natural resources of the world are in private hands. This may not be desirable, but it is undoubtedly an assumption on the existence of which our economic reasoning to-day is done.

Second, the feeding, clothing, housing, and transit of the world are left, with some few exceptions, in private hands.

Third, the authority of an employer or of a social class depends upon private control of valuable things.

Fourth, individuals possess the right of transmitting property from one generation to another.

Fifth, the individual has the right to make a contract and to have it enforced by the State.

Sixth, the individual has the right to acquire property.

Seventh, an individual has the right to move about in his own country provided he can pay his way.

Eighth, the driving force in modern economic activity is competition; but complete competition being impossible we sometimes get combination and monopoly.

Associated with these assumptions are certain other ideas which Professor Henry Clay in his book, "Economics

for the General Reader," has reduced to four; these ideas are (*a*) that men follow their own interest and, in doing so, unconsciously bring about a common benefit; (*b*) free competition results in the production of the socially fittest men; (*c*) private ownership of wealth results in the highest economic efficiency; (*d*) market values correspond to social values. These four points are much more questioned than they were before the War; but they do represent the basis of the social philosophy of a representative business man to-day.

The essential idea underlying economics is that of human motive concerned with the idea of self-protection and self-assertion and issuing in the appearance of wants; but since effort does not appear to function without reward, that is to say, in economics, since it does not function without income (rent, wages, interest, profits), the motive power, for all practical purposes, is desire for a thing plus ability to pay for it. In the language of the economist, this is called *effective demand.*

The Laws of Consumption.

When we begin to look at economics from the point of view of effective demand, we are at once concerned with what is known as consumption, which means the use of what is produced. The capacity of human beings for consuming goods so as to produce increasing productive power and give the maximum of economic welfare is not an aimless, purposeless activity, but works in accordance with certain tendencies, and of these there are three. There is the law of satiable wants, first formulated by the economist Jevons, which can be stated as follows:

"Specific wants are satiable; the more an individual has of one commodity the less he desires any further unit of that commodity." This applies to the appetites and physical desires. Next, there is the law of substitution or of variety, according to which satisfaction can be reached by a varied diet just as well as by having a quantity of one thing.[1] The modern study of nutrition opens an endless array of possibilities in this connection when we remember that, about the year 1776, in England, people had the choice of about four foods only. Thirdly, there is the so-called Engels' law, which takes a little explanation. It is true that children and savages live in the present and are not much concerned with the future; the poor also live in the present because they have not enough money to give them the chance of exercising forethought. Some people argue that to increase the income of the poor would result in extravagance. An experiment conducted in Germany suggests that this is not so; what Engels' law (formulated from this experiment) does suggest is that an increase in incomes results in a decrease in the percentage spent on food, no change in the percentage spent on clothing, the percentage spent on rent, light and fuel remaining about the same, but that the percentage spent on health, recreation, and education increases. Engels' law raises in our minds the whole problem of luxury. What is the luxury of one generation may become the necessity of the next. The production of luxuries may, *prima facie*, be good for trade, though most would agree that wealth produced to satisfy bad wants is a prostitution of labour, capital, and time.

[1] This principle applies, of course, to all articles of consumption.

Summary.

Before we proceed to attack our subject in all seriousness, we can with advantage just draw together the points that we have been considering so far. These are that economics is concerned with wealth; that, though economics may, itself, be a method of thinking, it employs the four normal methods of thought; that it is effective demand that calls forth economic activity, but that consumption does not work willy-nilly; it does obey certain tendencies or laws, and, once the essential needs of the individual are satisfied, there is a tendency for him to break out into additional expenditure, some increased standard of life or some form of luxury; that all this activity is simply the instinct of self-preservation and of self-assertion making its appearance in the form of wants.

Fertility, Production, and Potentiality.

All ages of men have been concerned with the idea of fertility. Some have referred to the cause of this as God; others prefer to use the term Nature; while men of science like to use some such phrase as "the universal law of causation." The same notion exists in economics, and it is usually associated with the idea of production. We speak of production as the wealth created in a given period of time and added to that wealth already in existence; it is then either consumed to keep people alive while they are creating more wealth or it is converted into an instrument for aiding people in their task of wealth creation. But wealth is not created for fun; it is made for the purpose of feeding, clothing, and sheltering

people, and, incidentally, to give the means of livelihood to those who take part in the process of wealth creation. In essence, what we do when we create wealth is that, being aware of the needs of people, we convert portions of our environment into other forms, and we move them from places where they are not wanted to where they are. This dual idea of the existence of individuals with needs to be satisfied, and of an environment which can be modified to meet the needs of these individuals, we shall, in this book, call potentiality, and because we shall be using it rather much, it will be well to be clear what we mean by it. It embodies two ideas: that of people wanting and willing to work for their needs, and that of an environment out of which can be lured by the intelligence of men the means of satisfying the needs. Both of these ideas taken together give us the conception of potentiality, a notion which contains the suggestion of possibilities without limit. Both these aspects of existence are important, because it is impossible to conceive of men without an environment or of an environment without men. It is the old idea of mind and matter, and, for the economist, of the domination of the environment by mind. Bring mind to matter and the result is potentiality, but the level of the potentiality depends on the extent to which mind can apprehend and convert matter to its own use. We must now put this general and abstract idea into a more concrete form.

The Factors of Production.

Environment in economics is generally referred to as land; the effort of the individual with needs to satisfy and

who is prepared to work in order to satisfy them is spoken of as labour; if the "needs" aspect of the individual is emphasized, then he is referred to as the consumer. But he is the same person with a dual personality—a capacity for creating and one for destroying wealth, and, fortunately, his capacity for creating wealth is much greater than his capacity for destroying it, though self-appointed moralists would have us believe that it is not so.

It is important, in considering land, to distinguish between it and land area or acreage, because the two are not the same and it is easy to confuse them. "Land" includes the sea, the air, climate, and what can be termed the general forces of Nature, whereas land area does not. Labour means the effort, either of hand or brain, used in doing things, and with this goes the idea of time in which people spend their effort, working upon land to produce things. Hence, we have three things—land, labour, and time—which, when they all work in unison, give us our economic trinity; and they may be called the elements of production. Land, labour, and time when in co-operation produce two kinds of things—those for immediate use and which are destroyed by being used, and those which are only used up gradually. The former types of goods are called consumption goods, and the latter are called instrumental goods. It is important to understand that both consumption and capital goods (machinery, roads, buildings) are built up as a result of the operation of labour upon land working in time; it is also desirable to realize that capital goods arose, in the first instance, as a result either of extra effort or of more intelligent effort, and not as the result of saving. To-day capital

goods and consumption goods are produced side by side, one portion of a nation's productive effort being devoted to one form of economic activity, and the other portion to the other; and these two forms of activity often get out of step, thus resulting in an upsetting of our economic equilibrium.

The Relation of Consumption to Production.

We can now endeavour to get clear in our minds the relationship which production bears to consumption. The production of a community may be considered as being made up of three elements—past production of capital goods which are still in existence, present production of capital goods and of consumption goods, and imports, both of capital and of consumption goods. Consumption may be looked on as being made up of the wear and tear on past capital goods that are brought into this year's account, wear and tear upon the new capital goods made this year, the destruction of consumption goods either by use or waste, and the export of both capital and consumption goods. It may be that no one has actually sat down and added up the elements that go to make up total production and total consumption in order to ascertain what was the ratio of consumption to production, but because of the factor of past capital goods alone, i.e. because of the efforts of the past which are our economic heritage, it seems clear that in any definite period of time productive capacity is considerably ahead of our power of consumption, and must always be so. But it is conceivable that, because of lack of effective demand, capital goods may be left lying idle; if this is the

case, then production is bound to diminish, and the ratio of consumption to production may be much higher than would be the case if the capital goods were not lying idle.

The Meaning of "Land" in Economics.

Let us now return to consider the elements in production that have been described as land, labour, and time. We shall begin with land. Every one knows that land appears to differ in fertility, and that as the result of extended research and experiment, the soil can be made to produce more by using manures, phosphates, irrigation, or by having resort to capillary attraction and dry farming. That is to say, the soil can be made more fertile than it is in its original state by spending more money upon it, by "dosing" it with capital. But experience has taught us that after a time the soil no longer responds, and successive "doses" of capital tend to produce a less than proportionate increase in return. This tendency is usually spoken of as the law of diminishing returns. Often, however, when the point of exhaustion has been reached and farmers begin to think that it is no use going on to "dose" their land, a new method of production will be discovered which will make it possible for the whole process of "dosing" to be begun again under new conditions. The law of diminishing returns still continues to operate, but the point of exhaustion is a continually moving one. The relative fertility of different pieces of land is also associated with the theory of rent, usually connected with the name of Ricardo—an economist who flourished in the earlier part of the nineteenth century. If we invest, say, £1,000 in land, it will be found

that different farms will give us a different return upon our outlay, and some farm will return us nothing at all over the cost of production. This differential return is known as rent. The farm that only just repays its cost of production is known as the marginal farm, and the movement of prices of, say, wheat more or less determines the position of the marginal farm in the scale of fertility, a rise in price bringing in other farms that were previously not cultivated, and a fall in price driving farms on the margin of cultivation out of production.

Labour as a Factor of Production.

We pass on next to consider labour. This term has no relation to any political party. The term refers to individuals who by their thought, physical strength, or craftsmanship contribute to the productive process. The "efficiency" of labour is a matter of its education, its organization, and of the extent to which it is skilfully directed in factory or workshop. Some forms of labour are organized into bodies; doctors are so organized, and so are miners. These bodies tend to set the standard of conduct for those who labour, and have much to do with the determination of the amount of remuneration. The incentives which are offered to labour to induce it to expend effort are quite important; sometimes the attraction is high remuneration, sometimes good conditions; sometimes it is an opportunity to determine the policy of the institution in which one works. But the main element in the efficiency of labour is education, because not only does it sharpen the intelligence, but it trains the will and so leads to higher standards of conduct.

Time as a Factor of Production.

The third element in production—time—is one about which we must say either very much or very little. What is its nature we may leave to the philosophers, but for the economist it is that aspect of existence in which labour works upon land in order to produce capital and consumption goods. Time, itself, is an element in economics beyond our control; we cannot either increase or decrease it, and it goes on in spite of us. On the other hand we can use it wisely or unwisely. That is to say we can intensify it or dissipate it. Carlyle once said of time—

> So here hath been dawning another blue day:
> Think, wilt thou let it slip useless away?
>
> Out of Eternity this new day was born,
> Into Eternity at night will return.

The Origin of Capital.

What interests the economist is the extent to which we can make the most out of our blue day; as it sweeps past our door we have to seize hold of the opportunities that it presents to us or else waste them. This idea takes us on, naturally, to see what we can do with time, and here we are driven back to our original idea that it is in time that labour works on land to produce capital. Capital, as the economist views it, is different from the idea which the accountant or the business man has of it. To them it is a sum of money that has been saved up. To the economist it is the result of extra effort or of more intelligent effort designed to create instruments or tools to make production easier. It is part of the process by which the work of the

world is shifted off the backs of men on to the backs of machines. The coming of the idea of money enabled men to "store" their extra effort for future use, and in this way the economist's idea of capital approximates to that of the business man. The function of capital is twofold; it is used to sustain labour while it is doing its work, and it is also used to supply the fund for the purchase of necessary materials for production, putting up a factory or some such similar activity. There are also certain ideas that are always associated with the idea of capital of which we must take some notice. They are four in number. Capital is supposed to be invested and not left lying idle; it earns interest; the State protects it; and, if it is converted into capital goods, it enjoys the right to upkeep. These points will be considered later, in their proper place; but it is desirable to associate them in our minds with capital, and that is why we mention them here.

Problem. Critically examine the statement that the origin of capital is extra effort.

CHAPTER II

SOME FUNDAMENTAL NOTIONS

WE now know something about the elementary notions connected with production. We can, therefore, press forward with the task of filling out the general picture of economic activity in the modern world. One of the first things to consider is the term *market*. This is an elusive term because it has no geographical location. But, before we make a frontal attack upon the idea of a market, there are other ideas to be considered.

Who Controls the Policy of Production?

In the good old days, individual men, taking the initiative, used to estimate what were the needs of people, and used to produce goods that were required with their own capital, which was largely the result of their own extra effort. But, with the development of modern industry, these conditions have considerably changed. In principle, to-day, what goods are to be produced is decided by those who are going to put up the money to finance the production that is involved. This does not mean the shareholders of a company, though they are—of course—indirectly concerned. It means the bankers who, in the main, finance modern industry, because before a firm can embark upon a new policy of production it has to get its plans approved by the bank from which it is going to borrow, unless of course it can get along without borrowing of some kind. This means that in modern industry

the determination of policy, in a general way, is a function of finance, and finance to-day means the bankers. Once the policy of production has been approved, then the administration of that policy becomes the task of the general manager and of his officers. This is true of production in the firms engaged in manufacture, but such a condition of affairs does not apply to the retail shops which are engaged in selling the goods that have already been produced. The next stage in our chain of ideas is that the money that has been lent to the firm becomes distributed as wages, salaries, and, at the end of a year, in dividends. But there are other payments, such as those for raw materials, made by the firm to other firms, which never get into the hands of individuals at all; they go to firms, possibly to further firms, and then back to the banks. The effective demand of the consumer is made up of the moneys distributed as wages, salaries, dividends, and profits, and these constitute the fund available for the purchase of goods that ultimately find their way into the distributors' or retailers' shops. Theoretically, the amount of money distributed as purchasing power should be able to buy up the goods in the retail shops, but, in practice, this does not happen.

Difference Between the Banker and the Business Man.

It is very desirable that we should understand clearly the difference in function between the banker and the business man. The banker is the man concerned with making available to business men sufficient funds to carry on business; the business man is he who undertakes to

co-ordinate and organize the productive forces. The business man may have funds of his own, in which case he is a capitalist, or he may raise funds from his friends or from the public, but the normal way to-day is for the business man to rely on the bank. The business man is, therefore, largely an administrator, the limits of whose activities have been mainly determined by the banker. At any time the banker may "put the screw" on the business man and call him to heel, and there are very few businesses that are not in some way beholden to the bank. Very often the extent to which a business expands or contracts is decided by the banker, and in this way the employees of the business man find that the volume of employment is determined not by their immediate employer, but by the banker who stands silently in the background.

The Nature of the Market.

With these preliminaries out of the way, we can now face the question with which we began this chapter, viz. a consideration of the market. The market is made up, generally, of the purchasing power that has been distributed by the processes of production, and the problem of the business man is to ascertain how much of this market can be made available to him for the sale of his goods. He knows how much his goods have cost him, so that he knows the limit below which he cannot go in his price. The organization of the market resolves itself into the problem of the various grades of markets, such as the wholesale market, the retail market, the cereal market, or the boot market. The central problem in every case is

to ascertain the size of the market and to relate the productive forces (of the contributors to the productive processes) to the size of the market. The problem becomes the greater, however, as the market enlarges from local to national market, and then to world market. This is why, in modern business, so much attention is paid to advertising, to transport, to feeling the pulse of the market, and to obtaining market information.

The Producer-Consumer Relationship.

This brings us to that very interesting relationship which is so characteristic of modern economic activity—the producer-consumer relationship. In medieval days this relationship was a personal one, and there is little doubt that some of the producers found in their work a means of self-expression. This relationship has been almost completely changed by the development of large-scale production and the use of machinery. The consumer of post-war years rarely sees the producer of the goods which he uses, and very often he may live in another part of the world. The producer-consumer relationship is one of opposed interests. The owners of production, i.e. the companies or employers, are concerned to obtain the highest possible price for their goods; those who make the goods, when they assume their consumer personality, desire to buy as cheaply as possible consistent with good quality. There is very little of the "higgling" of the market in these days in the relationship between retailer and consumer. If there is any "higgling" it comes earlier in the process of production.

What determines the consumer in coming to a decision

about how he will spend his money? To this question there are many answers. It is said that he weighs up one possibility against another until he is finally able to decide what will give him the maximum net advantage. This, it appears, is a highly theoretical explanation. Competent housewives may do it with small amounts of money to spend and many mouths to feed, but it is not true of the action of many other folk. Most of us buy what we have to and get the best for our money that we can, but our purchasing is usually done in a hurry, and we rarely get exactly what we want; we have to accept what choice is possible out of the standard lines that are offered to us.

We have now completed the general picture of economic activity in the modern world which we began in Chapter I. We have managed to avoid technical terms and the abstract ideas so beloved by textbook writers. With this general picture in mind we can go forward to a more systematic consideration of the whole field of economics. We shall begin by having a peep down the vista of the future; and then we shall follow up our peep by making a first-hand study of the essential features in the view.

The Divisions of Our Subject.

We return to the idea of potentiality. What we are now concerned with is the task of developing it, and of its control. To do this in as interesting a fashion as possible, it is proposed to chop up our immediate task into seven pieces, every one of which will be an aspect of potentiality, and all of which, taken together, will give us a unity. Since a high level of potentiality is what we aim at, we use, in

modern economic activity, seven devices for accomplishing our aim. These devices may be roughly described as—

(*a*) The device for mobilizing potentiality in its financial aspect.

(*b*) The device for mobilizing ability.

(*c*) The device for rendering ability efficient.

(*d*) The device for estimating wants.

(*e*) The device for facilitating distribution.

(*f*) The device for coercing supply.

(*g*) The device for coercing demand.

In a sentence, we are concerned with getting the economic machine ready to do the work of feeding, clothing, and sheltering the community, and of providing means whereby we can either speed it up or slow it down so that the needs of the community and the output of the machine may be in balance. This condition of affairs, if attained, may be referred to as economic equilibrium. Once we get it we have reached the economist's kingdom of heaven, a condition of affairs never yet attained.

Problem. Is it in the interests of general economic welfare that the policy of production should be determined by finance?

CHAPTER III

CREDIT AND LABOUR

THERE are many devices used for mobilizing the financial potentiality of the community; and, strictly speaking, before attempting our present task, we should have something to say about money. Discussion on this subject, however, is deferred until Chapter VI.

The Joint-stock Company.

The most important instrument for mobilizing financial resources is the joint-stock company, particularly that form of it which is known as a bank.

One of the earliest forms of the company was the regulated company of the Merchant Adventurers. In this form of organization the Merchant Adventurer put his own money into the venture, whatever it was. Then came a development where merchants combined to make up the required capital, but took it all out again when the venture was completed. The next development after this was the idea of joint stock, where, at the conclusion of the project, the capital was still left with the company.

Then came the partnership, which was the normal form of organization for the earlier part of the nineteenth century; finally came the modern joint-stock company with limited liability in 1862.

The Difference Between a Bank and a Stocking.

It is not intended to bother the heads of readers with the technicalities associated with joint stock; we want to come to the essential instrument for mobilizing financial resources, viz., the bank. Let us begin by asking ourselves a fundamental question: What is the difference between a bank and a stocking? Originally people used to store the money that they did not want to use in some convenient place, such as an old stocking, in a tin, or under a loose board in a room; sometimes resources were buried. The French housewife, for example, has a great reputation not only for being able to accumulate money in this way, but for keeping control over it rather than hand it over to any person or institution to keep for her. When, however, bankers managed to persuade people to deposit their money with them, this was an interesting and useful development. It meant that if you had £5 stored in your stocking and you handed it over to a banker to keep for you, both you and he had the right to use it, and his right to use it in no way impaired your right. But this was not the limit to the development of the banker's power for mobilizing potentiality in its financial aspect.

The Nature of a Bank Deposit.

It is generally imagined by the public that the main service which the banks perform is that they collect little sums of money and make them into one large fund out of which loans are made to the business community. This is not quite what happens. What really happens is that when business men and others want to borrow from a

bank, they visit the manager and explain why they want to borrow. If the loan is made, the borrower draws a cheque against his loan and with the notes, copper, and silver that he receives from the bank he makes his payments. The recipients use this money to pay their bills, and the people who receive this money pay it into their accounts and increase the deposits of the banks by, approximately, the amount of the loan which the borrower originally obtained from the bank. In this way, by means of a loan, an advance, an overdraft, or by the cashing of bills, the banks are able to increase the volume of deposits in the community, and because of this process it is not correct to say that a bank only loans out deposits which people make with it. It is clear that it creates the deposit by the issue of the loan; the loan travels back to the bank or to another bank and assumes the form of a deposit. But this is not the end of the story. It has to be remembered that when our borrower goes to return his loan to the bank what he does is this. When he feels that he is in a sufficiently strong position to repay his loan, he draws a cheque against the funds which he has accumulated in his account, and so reduces them by this amount. The bank, upon receipt of this repaid loan, then reduces the total amount of its loans by the amount of this repayment. In this general way, then, it can be said that a bank loan creates a deposit, and that the repayment of a loan destroys a deposit. Doubtless the average citizen imagines that the process is the reverse of this—that a bank loan reduces deposits, and that the repayment of a loan increases them. Such, however, is not the case. The principle which has just been expounded is

a very important one, because various developments upon it can take place.

Illustrations of Credit Creation.

For example, a Government may borrow from a bank, and the loan, when paid out by the Government to contractors, civil servants, and others, increases the deposits with the banks; while, when the Government repays the loan, the effect of this repayment is to decrease deposits. Again, when it was deemed desirable during the War for the people to subscribe to the War Loans, the banks used to advance people money to buy War Loan stock, the banks retaining possession of the scrip. When people had saved sufficient money they repaid the banks for their loans and received back their scrip, which, if they so wanted, they could re-pledge for further loans. Later, we shall return to this power, possessed by the banks, for creating credit, when we come to discuss money, credit, and banking. In the meantime all that is wanted is to point out to readers what, exactly, is the difference between a bank and a stocking as an instrument for mobilizing the financial resources of the community, and as an instrument for raising the level of potentiality in its financial aspect. If the above explanation has been understood, it should be clear that a stocking is a receptacle in which are placed not only legs but money; on the other hand, the bank is not merely a receptacle for the deposit of money, it is also a financial dynamo, able to generate out of itself financial energy which flows out and returns to the banks, just as electricity is generated. There is one other aspect of the bank's power for mobilizing financial resources.

That is, it lends money against property to people who want ready money. As an illustration of what is meant, assume that the owner of a valuable property, equipped in a suitable way, is without ready money and badly needs it. By handing over the documents governing the property, he can obtain ready cash in return for the control of the property. In this way the banks are able to convert the fixed assets of the community, such as land, buildings, machinery, and similar pieces of property, into liquid funds for the use of the community. In principle there is nothing different in this process from the one described above; it is merely another illustration of the difference between a bank and a stocking. It should be pointed out, however, that the banks cannot go on creating deposits to any amount. There are limits to their power to do this—but these we can consider in another place.

The Relation of Money to the Market.

We must now relate this general idea of the mobilization of the community's resources to the problem of the market. Originally, people used to barter goods for goods, but with the development of money every unit of goods or of services acquires a money value, and what people do is to turn their goods or services into money, and in this way buy for money the goods or the services that they want.

Since effective demand is the force that lures out productive effort, it is only logical that producers will look to the sources of greatest effective demand in deciding both what and where to sell. With this idea in mind we

can imagine a business man standing, as it were, at the centre of a circle, surrounded by a community's population whose volume of effective demand shows varying shades of red, being pink where effective demand is low and a bright red where it is high. Our business man stands at the centre of his circle ready to rush his goods to those areas which show red. It is competent for us to ask where these purchasing power "points" will be. There will be more in towns and in centres of population than in the country; there will be more at times of industrial development than at times of industrial depression; there will be more among people with high incomes than among people with low ones; there will be more at Christmas-time than at other periods of the year.

Devices for Rendering Labour Efficient.

There are four ways in which this may be effectively achieved: by having in any firm a "thinking" department, by understanding the principles of administration, by using an intelligent "roster" system, and by selecting suitable people for doing the necessary tasks. We shall begin by assuming the existence of division of labour and of specialization in the factory system in the representative form in which we know it to-day; and we assume a certain amount of scientific management.

The "Thinking" Department.

It is desirable in any form of organization which is arranged as a business that there should be in existence a "thinking" department, however small, charged with

the task of doing the intelligence work of the business. In many businesses this work is done by an accountant, particularly where there is a system of accountancy-control at work; but this is a mistaken policy because accountants, as a result of the specialized form of education and training that they have had, have developed the qualities of caution and unimaginativeness to a very high degree. These qualities, excellent in the work of accounting, are not suited to doing intelligence work in a large business where psychological insight and imagination are particularly in demand. The department is best staffed with University men who have had an Arts training, and who have a good honours degree. The function of men in this "thinking" department is to obtain information, to observe and to experiment. Upon the results of their work all administrative decisions should be taken. Their commission should be a roving one, and their education, and their associations during their education, should enable them to take an objective and reasonably impartial point of view. The decisions taken as a result of the work of the "thinking" department should flow out to the administrative department.

The Administrative Department.

The principles which should govern the working of this department are few in number, but they are very important. There are seven of them—

First, as far as possible, one man should have one job. Because of the smallness of the business, this is not possible in some cases, but "one man one job" is the ideal at which to aim.

Second, one man can control only from three to eight men. The lower down in the ranks of employment men are, the more can one man control—say eight; the nearer the top we get the fewer number should one man control; right at the top, one man should control about three.

Third, it is essential that each department or section of a department should have someone in control, and that responsibility should be centred at the top; that is, if anything goes wrong in a department, it is the man at the top who should be regarded as being responsible—there should be no interference with individuals in the department by superior administrators from outside.

Fourth, every principal should have an understudy who should be paid considerably less than, though he should be given ample opportunity to do the work of, the principal. The principal is paid for carrying the responsibility; the understudy is not—he is merely in training for his higher work when the opportunity offers; but the understudy should be fully practised in doing the work of the man above him so that he may take it over at a moment's notice.

Fifth, when cases of friction develop—as they are almost certain to do—it is better that a reprimand should not be administered direct by the head of a department, but that the reprimand should come from someone above him, and that it should be administered indirectly to the offender through the head of the department, but in the presence of the offender. The reason for this may appear to be obscure, but it is mainly psychological. To bring in not the head of a department but the man above him

should remove any suggestion of personal spite or bias, and it shows the offender that his inefficiency has repercussions outside as well as inside his department; to speák to the head of a department about the inefficiency of one of his staff in that member's presence strengthens the theory of responsibility at the top and engenders a feeling of loyalty in the breast of the inefficient person, and should make him realize that his shortcomings have a wider range than he imagined; finally it has the psychological effect of making the inefficient person the impartial observer or spectator of his own weakness.

Sixth, the channel for complaints from below should not be through the immediate superior but should be through an independent person, who might be known to all as the "complaints and suggestions officer"; no greater mistake, psychologically, could be made than to imagine that complaints can be squashed or ignored—such an attitude only drives them underground; and the only way in which people can be induced to grumble so as not to harbour unhappy thoughts is for them to realize that there is an independent officer, specially chosen for his gifts of personality, to hear and handle complaints and suggestions when they arise.

Seventh, there should be maintained a man, who might be called a rover, to move about the business oiling the wheels of human relationships, and being on the pulse of things from the bottom to the top, with power to put things right when they are wrong and power to make emergency decisions should the need for them arise. There is no reason why this man should not be the man who is the complaints officer.

The Roster of Work.

Consideration of the work and duties of this man naturally leads us on to the next section of our discussion, the "roster." Those who have had anything to do with groups of people who, collectively, have to perform a certain task, learn by experience that men cannot work at a steady, uniform rate of output. In support of this experience of practical men is the finding of industrial and educational psychologists. It is now established that fatigue is a poison that permeates the blood and that this induces the tired feeling; we also know that when men begin a task it takes a little time for them to warm up to their work, so that the highest pitch of their efficiency is reached about the middle of the morning and not during the first hour of work. After this period of maximum efficiency is over, fatigue begins to set in, and mistakes and accidents begin to occur. Now it follows from a study of this normal ebb and flow of productive efficiency, established both on psychological grounds and in the experience of practical men, that there should be some principle of arranging a day's work that will meet both the condition of the men and the requirements of productive efficiency. These principles are three in number: first, that the most difficult and exacting part of the work should not be required of men before they are warmed up to their work or when they are exhausted; second, that, if speeding up or exacting work is to be done, the second period of work is the best time for it; third, that, when this period is over, and before passing on to the third period, a rest should be allowed in order to permit men to get the fatigue out of their system; exercise,

ventilation, and facilities for smoking should be afforded, while it is quite remarkable what effect music has upon jaded nerves and systems that are feeling the effect of lassitude.

The Selection of the Labour Force.

We come, finally, to the principles that should guide us in selecting individuals for performing tasks. At the outset, it is desirable to realize how serious is the effect of under-education upon, approximately, 85 per cent of the people in any community, because the school-leaving age is set as low as fourteen. No very great intelligence, or high standards of conduct, or well-formed habits can be expected from men with an inferior educational background. A low standard of education, on the one hand, and the ever-enlarging scope of machinery on the other, are making it more and more difficult for individuals to earn their keep in modern industry. In selecting men for service in a business, pride of place should be given to men with some reasonable standard of education. Following upon this can come other aids, such as intelligence tests, within reason, and other practical tests which the nature of the business suggests. No man should be given permanent appointment until fitness for his work over a period of time shall have been attested. Finally, any sound method of business organization will make provision for the continuous inspection and appraisement of the abilities of its employees. This suggests that any reasonably efficient business of any size should have a training officer specially charged with the task of continuing the education and training of the

men *after* their appointment. If such a man is appointed, he should not be wholly unfamiliar with the fundamental principles of education and of psychology.

Problem. Draw up a scheme for running a business in terms of the administrative principles outlined in this chapter.

CHAPTER IV

WANTS AND THEIR SATISFACTION

We now know something about the way in which human thought, working on matter, produces wealth; we also know how the extra effort of the past is converted into and stored as financial energy, and how we can intensify time by having human endeavour well organized and thus increasing its efficiency.

But our two devices for doing this are not all the devices which we require, because in economics, as in every other body of knowledge, "there is many a slip 'twixt cup and lip." The next two devices that we have to consider are, first, that for estimating "wants" and, second, that for facilitating the distribution of the wealth that has been created. The need for these two devices is obvious because it is no use making wealth for people if they do not want it, and there is waste effort in putting goods where they are not wanted, or, alternatively, in placing too many goods in the possession of some people so that they are "glutted" and, on the other hand, too few goods in the hands of others so that they are under-nourished. Any of these three eventualities upsets our idea of economic equilibrium and obscures our conception of a market in which a balance is maintained between the output of capital goods and the output of consumption goods on the one hand and

the effective demand that has been distributed on the other.

There is no portion of the field of economics in which more stupidity is shown by mankind than in these two aspects of economic activity—the estimation of wants and the distribution of effective demand—and because of this stupidity we omit to raise the level of our potentiality as high as we might.

The Device for Estimating Wants.

Any proper study of human wants involves some knowledge of human psychology; and we have to distinguish between what people want and what they ought to want. The ideal thing would be for people to want what they ought to want.

At the present moment many people are making money by producing things that people ought not to want, because, human nature being what it is, it is easier to supply the wants of human folly than to supply the wants of wisdom or of common sense, since human folly lacks a sense of discrimination. Therefore, we begin the study of human wants by bearing in mind an important psychological principle that in their inmost being and in their inmost mental and emotional life all human beings are reaching out after *their* conception of personal sovereignty; and those whose task it is to make goods for the market at a profit to themselves know that this search after personal sovereignty, *as consumers conceive it for themselves*, has to be met, because those who try to bend the wishes of individuals into the straight and narrow paths of moral consumption never make money.

And since producers are not schoolmasters or clergymen, morality in consumption is not a producers' principle. "Give the public what it wants."

What Does the Public Want?

First, it wants the fundamental things that make for personal sovereignty—food, clothing, and shelter. Second, once people have these things, they want things that enhance the individual sense of prestige—more delicate food, more refined and tasteful clothing, and more elaborate shelter. Once this second type of need is met, human wants should be satisfied, though, in point of fact, we know that they are not, because of the element of psychological discontent in most of us; from reasonable satiety we go on to display and extravagance because, in our own judgment, they are the necessary accompaniments of personal sovereignty.

Two New Terms.

We must now introduce into our discussion two new terms that are essential to any consideration of needs, because these terms describe two characteristics of needs without which we could not possibly understand them. These two terms are "inelastic" and "elastic" demand. These are satisfactory names for them because they are so accurately descriptive. Inelastic demand is demand that must be satisfied regardless of price; elastic demand is that which varies appreciably when the price of a commodity is changed. It is not possible to be precise in our definition of the forms of wealth which can be arranged

under these two headings, but it is convenient and reasonably accurate to suggest that for necessities there is an inelastic demand, and for other goods there is an elastic demand. At this point we can remind ourselves of the law of substitution, which tells us that when an article is unprocurable or when it becomes too expensive we substitute other articles for it.

Aids to Estimating Wants.

An intelligent community, bent upon planning ahead, can call to its assistance certain aids in the task of estimating wants. For example, statistics of population and its distribution according to sex and age are fundamental when we consider what amount of wheat, wool, and leather is required during a year. To this aid we can add statistics of births, deaths, and sickness. Further, if we take medical and scientific advice about diet and clothing, we can greatly reduce the problem of estimating the needs of the community for food, clothing, and shelter. All countries learned much about the art of doing this during the War. Once we get beyond the necessities of life, people's wants become a matter of taste or of idiosyncrasy, and these have to be carefully studied and estimated. When measured they can then become standardized as fixed "lines." For articles of display and of extravagance the problem of estimating is not so serious because those with sufficient "effective demand" to indulge in display or extravagance generally prefer to have things made to their order. The problem of estimating demand ahead of supply is, therefore, confined mainly to the second type of goods which lie between necessities and luxuries.

How to Correct Mistakes in Estimates of Demand.

It is beyond the capacity of human ingenuity to make these estimates ahead of demand accurately, particularly in a business regime in which competition plays such an important part. We have, therefore, to devise means whereby we may correct any mistakes. There are such means, and, in order to help to fix them in the mind of the reader, it is proposed to give them rather fanciful names, viz. suggestion, economic force, and economic rest-rooms. If, in a programme of production, we have "overshot the mark" by over-producing or by producing something that is not quite what is wanted, then resort may be had, in the first instance, to suggestion to induce people to buy the goods. This can be done in three ways: (*a*) by advertisement in the press or elsewhere—for example, in the cinema; (*b*) by means of education in the art of consumption—for example, makers of certain kinds of bread or of flour indicate to customers by some special demonstration, the advantages of the goods that they are selling; gas companies do the same thing when they want to sell a certain type of gas ring or oven, and motor-car sellers continuously do it; (*c*) by price-cutting on certain lines in order to induce people to come to your shop—once they are inside the shop they may be led on from one kind of purchase to another. If it is found by this device of suggestion that people still do not buy, then it is necessary to resort to a stronger weapon—economic force—though every producer is not always in a position to use it. The following three aspects of economic force are used in varying degrees by firms according to their strength. The first is the reduction in the number of customers' options

in the purchase of goods until the goods which the seller has on his hands are sold. Next comes the policy of short-circuiting the supply of those goods likely to compete with the goods that it is desired to sell. Thirdly, there is the sales association, the conscious organization of a body of men who take concerted action to force the sale of goods upon the public. This last method can be adopted only when the goods to be sold are sold under conditions amounting approximately to a monopoly.

If for various reasons the goods to be sold cannot be sold either by suggestion or by economic force, then industry resorts to the economic rest-room to relieve it of its troubles. That is to say, it falls back upon various types of credit assistance that have grown up in recent times. The seller goes to the wholesaler from whom the goods have been purchased, probably on a month's or six weeks' credit, and asks for an extension of his period in which to pay; the last resort is to apply direct to a bank with the request that the bank will "carry" the retailer for a period of time until he can sell his goods. It must not be imagined that the whole system works in the orderly fashion in which it is here described, or that all these devices are used by the business man anxious to sell his goods, but the above account is an attempt to systematize varying business practices. These economic rest-rooms, as we shall see shortly, are of the utmost importance because in times of depression they provide a means whereby the evils of the depression may be averted or resisted. When the central banker is on the warpath with the fowling-piece of deflation, the retailer-rabbits fly to their rest-rooms and there, for a period of time, find

immunity from the predatory onslaught of the financial Nimrods.

The Device for Facilitating the Distribution of Goods.

Once we have estimated the wants of the consumer and have provided against over-production of goods, or, at least, for making recovery once we have "overshot the mark," we proceed with our programme of production, and we interestedly watch our factories pouring out goods. The problem that faces us now is what is the best way of getting these goods distributed to the folk who want them. We can pursue two policies, one based on force and the other on inducement. Under the former policy we should ration every one; under the latter we offer, as an inducement, money to people in return for the service which they perform in helping to produce the goods; and on the amount that they earn will depend the volume and the quality of the goods that they can take from the general pile. The former method—rationing—we do not know very much about; we had a little of it during the War as civilians, the soldiers were rationed, and at present people are rationed in Soviet Russia. Under a policy of inducement, goods will tend to move to those areas where purchasing power is great, or to where units of purchasing power are concentrated owing to dense population, as in a big city, or a railway gang near a small village.

Weaknesses in this Theory of Distribution.

But there are an enormous number of difficulties in this theory of distribution by means of inducement. One of

the best ways of explaining this theory will be to discuss some of the difficulties. Their names are speculation, fluctuations, and unemployment. But, before doing this, we should devote a little attention to an instrument for facilitating the distribution of goods, in an indirect way, called the Stock Exchange. This is an institution that has grown up to meet the needs of the time. Its function is to collect information about needs and about goods, and to adjust them to each other. But it does not do this directly; it does it indirectly. If it is remembered that a shortage of goods is generally indicated by high prices, and a surfeit by a fall in prices, it can be seen that an institution that collects together experts engaged in trying to buy stocks and shares of those things which are rising in price and in trying to sell those things that are falling in price, must exercise some influence upon the flow of money into some forms of investment and out of others.

Speculation.

We are now in a position to discuss speculation. It will be agreed that the art of self-protection requires forethought. The extent to which we look ahead is often the measure of our success or failure. Since the bulk of the world's production is done upon an estimate of demand, ahead of actual demand, this must in the very nature of things involve speculation. This speculation will be of two kinds: that in regard to productivity and that in regard to effective demand. The factors which influence supply, i.e. production, are four in number, and they all have to be considered by estimators or speculators. The

first of these factors is climate and the seasons, which pre-determine the volume of the physical output of things like wheat and wool. Owing, however, to the increasing efficiency in the distribution of information, and in the growing amount of accurate knowledge about climate, the factor of risk in regard to it and the seasons is less than it used to be. The second factor is the influence of science upon invention and the repercussions of this upon machinery. No one knows when an invention is going to render useless all the time, effort, and money that have been put into certain forms of machinery and processes. This is a most potent factor of risk that has to be considered by speculators. Thirdly, there is always the risk of "cornering," i.e. that some person or some group of speculators will gain control of either all or a sufficiently large proportion of a certain commodity so as to make its future supply and price uncertain. "Cornering" is not nearly as common now as it used to be. Finally, there is the influence of substitution in supply; that is to say, the fact that nearly all commodities have substitutes keeps producers and those who want to invest in production all hot and bothered because of the uncertainties involved.

Turning next to the side of demand, we find that here, too, there are several factors that make for uncertainty. First, there is the doubt, always present, as to how people are going to use the money that comes to them in the way of wages, salaries, and dividends. People may do three things with their money; they can leave it in a bank or similar institution, they can invest it, or they can spend it. That is to say, they can devote it to the task of emptying the retail shops, or they can save it, or they can have it

devoted to the making of capital goods. Whichever of these courses of action takes place, it may be supposed to have some effect upon the intention of the speculator. In addition, there are three other points to be mentioned, two of which present considerable difficulties and cannot be fully explained till we have come to our discussion of money. These three things are inflation, deflation, and "calamities." The last have a definite effect upon what people do with their money, for if their property is destroyed in an earthquake, or if the rate of interest rises in an earthquake area or in a district where there is famine, the changed conditions will naturally affect what people do with their money. The influence of inflation and deflation, in that it alters the command which money has over goods, is a source of considerable anxiety to those who are trying to anticipate the future.

Fluctuations.

The second difficulty in our discussion of the inducement theory of distribution is concerned with what is known as fluctuations. They are different from speculation in that they come about in the nature of an act of God, whereas speculation is the conscious attempt of men to measure the future—that is to say, it is subjective in that it is dependent upon the will of man. Fluctuations are objective, though their causes may be the same as those which bring about speculation. Speculation and fluctuations are manifestations of an ailment in our economic body; they are indications that we have not yet mastered the art of manipulating our potentiality—that is, of applying thought to our environment.

Unemployment.

The third difficulty in the inducement theory of distribution is the factor of unemployment. In the modern world the only way in which to get hold of money is to work for it, or else to steal it or to manufacture it. The last two methods are illegal. Hence the first is the normal method of obtaining possession of effective demand. The rate at which consumption goods are lured out of the retail shops, and the rate at which the making of capital goods is stimulated, depend upon the extent to which the community is in full employment, earning money. No one seems to know exactly what is the cause of unemployment and no one seems to be able to cure it. Therefore, unemployment is a most potent cause of friction in the smooth working of our financial and economic system. The existence of unemployment greatly impairs the effectiveness of the idea that as goods are produced there is cast off, in respect of them, money units in the form of wages or salaries which can be used to purchase them when they reach the retail shops.

The Evil Effects of Unemployment.

We may conclude this chapter by observing that unemployment is undesirable for three reasons. First, it reduces the size of the market for the sale of goods—that is to say, the unemployed have no money with which to buy goods, and in consequence the effect of their demand in the retail shops is not felt in emptying them. Second, it causes inefficiency among those who are unemployed—that is, it reduces the potentiality of one of the factors of production. Third, it degrades human beings by making

them feel that their services to the community are unwanted. This makes the unemployed disgruntled; and disgruntled individuals are always a source of danger to themselves and to the community.

Problem. Indicate how the law of substitution may operate so as to interfere with a person's estimate of demand.

CHAPTER V

SUPPLY AND DEMAND

In the last chapter we were concerned with the task of discussing the problem of estimating wants and of distributing goods. We come now to the problem of increasing the supply of goods on the one hand and of increasing effective demand on the other. Following upon our plan of using the word "device" to describe these ways of getting things done in economics, it is proposed to call these new things the devices for coercing supply and for coercing demand.

Malthus and the Shortage of the Food Supply.

It is to be supposed that at one time or another everyone has felt the desire to speed up the production of commodities. Times at which such ideas come to us are at the opening of a war, or after a huge earthquake or some such disaster. This is a psychological attitude that has come down to us from the past; it is part of the residue of apprehension which has its roots in heredity, and is part of the emotional accompaniment of man's fight with Nature, of the attempt of mind to understand, control, and dominate matter. Malthus, the first of the Cambridge economists, had something to do with this idea when, in his celebrated essay on population, he pointed out that, unless man exercised forethought, there was a danger that the food supply would fall short of the growing population. During the early years of the nineteenth

century and, in fact, earlier than this, much money was made in agriculture, industry, and trade. In this money-making the employing and financial classes of England led the way. The surplus extra effort, as it was converted into money, was devoted to making three forms of capital goods—to obtaining possession of and developing new sources of supply of food-stuffs and of raw materials; to developing and improving the industrial plant and machinery; and to developing the means for moving the food and raw materials from places where they were not wanted to places where they were—that is, there were developed forms of communication, such as roads, railways, and shipping. This enormous development in the capital goods equipment of the world was made possible by the projection of the banking systems of Europe into the corners of the world through the medium of the credit system and the international loan. The way in which this was done was for the funds to be assembled in London, or in some such capital and financial city; the next step was to buy the necessary equipment that was required—agricultural machinery, implements, steel rails, ships—these being paid for out of the loan funds which had been accumulated for the purpose. These goods had then to be sent overseas to the United States, South America, India, Canada, China, and Australia, and the interest due on the loans was remitted to London through the medium of food and raw materials, which, when sold, provided the funds out of which the interest payments could be made and the repayment of capital effected. This was the method used for coercing supply or for overcoming the fears raised by Malthus. The extra effort of the eighteenth century was

given a monetary form; this money was invested in new countries and in backward areas; human labour and intelligence followed, and in this way the forces of mind were pitted against those of Nature in all parts of the world; spare energy was drained out of Europe into the Americas, Australia, Asia, and Africa, and was set to work in a new environment.

Repercussions from the Policy of Coercing Supply.

This export of money and of men to new areas had some curious repercussions. These were felt both at home and abroad. The whole banking system had to be remodelled, as did the industrial organization; new avenues of employment were opened up, and new ideas of education arose; while not the least important of the changes was the redistribution of the population of Europe. The least understood part of the process was the financial one; and, as has already been pointed out, the money put into overseas investments and international loans did not come from the savings of the people in the employing and financial classes—though a portion of it may have done; it came out of the process of creating loans, described in Chapter III, which in turn resulted in deposits either in, say, England or in the overseas countries; and this increase in the volume of circulating media both in Europe and in other countries had repercussions upon the level of prices which not many people understood at the time. This had interesting effects upon the political parties and their policies, upon the relations between capital and labour, upon the attitude of peoples in backward countries towards England and Europe. The general

process or movement laid the foundations of economic imperialism, and created the nineteenth-century British Empire as the leading exponent of economic imperialism.

The Accompaniments of Economic Imperialism.

Accompanying the development of economic imperialism were two systems which, though apparently thought to be necessary at the time, have created very much difficulty since, and are not unconnected with the wars of the nineteenth century and the great European War (1914–18). These two systems were the trust movement, and its allied associated developments, and the system of economic or financial control directed from the various financial centres of the world.

The trust movement arose to satisfy the need created by the spread of cut-throat competition, and was aimed at obtaining control of every stage of production from the raw material to the finished product. Its main home is America, but it is found elsewhere. In Germany the same type of thing developed in the cartel or the sales association, where all of the firms in an industry work on a quota system and hand over their products to be sold by the cartel. These huge trust organizations have now become world-wide, and are quite international in their outlook. They and their associated subsidiaries and associated industries form nations of their own, far-flung throughout the world, with their own newspapers and magazines. Their existence raises a very interesting problem about the future of our economic civilization. The available evidence suggests that the future of capitalism will be along one of two lines. Either industry will continue to

concentrate itself as it has done in the Ruhr in Germany, or in Pittsburg in the United States, and economic power and survival will pass to those industries which are most highly concentrated and most carefully organized in respect of raw materials, industrial equipment, communication, information, and distribution; or else power and survival will pass to those financial institutions which concern themselves with the task of advancing credit to these industries, and are content merely with determining the policy of production of the centres of industrial concentration, and nothing more. The big struggle in Germany after the War was a struggle exactly on these lines, Stinnes fighting the battle for industrial concentration against the domination of financial interests, and, as we know, Stinnes was ruined.

The other development, the movement of foreign financial control, arose, we may suppose, out of the nature of the case. Powerful individuals or groups in nations, having lent money abroad, became anxious for the safety of their investments. They therefore arranged, either directly or indirectly, through the Foreign Office of their own Government, some safeguard. The safeguards took three forms. The first was the earmarking of the taxes of a new country or a backward country as security for the interest payment and principal of the loan; sometimes only one tax would be so earmarked. The second form of control was that advisers and technicians, selected from the lending country, should be given positions of trust in the new or backward country in order to supervise the expenditure of the money and the recovery of the interest. The third way of protecting foreign bond-holders was an

international agreement whereby, provided a backward or new country admitted its debt, force could be used to recover principal and interest—but there was the proviso that before there could be a resort to war, there had to be a meeting of the parties, and the defaulting one had to admit its obligation.

On the whole, this policy of coercing supply through the development of new countries and backward areas has been overdone. The intense economic jealousies created by it had much to do with the great European War, with the present (1931) position in India, and with that in China; it leaves the peoples of Great Britain and the United States scowling at each other. One repercussion from the general nineteenth-century policy of coercing supply has been the rise of a new economic civilization in Russia.

The Device for Coercing Demand.

This portion of our subject brings us to the difficult question of money. It is not proposed to go into the origin of money or to classify it; but what we are concerned to do is to try to give a brief and clear exposition of a device which has been invented for increasing or decreasing its supply and purchasing power, almost at will. Money was originally a medium of exchange, something into which a producer could turn his goods, and the labourer his service, in order to make living more convenient, and to get rid of barter. For centuries money consisted of metal which in itself had intrinsic value, and it was often weighed rather than counted out; in primitive times it consisted of things other than metal—

cattle, stones, and shells. The idea that the metal shall have intrinsic value has almost vanished to-day, though we do find it in the British sovereign, for example. At some time during history, documents, signed by men of repute, came to be regarded as money, and so powerful did these men become that they could create money when they wanted to, just as the joint-stock banker can create deposits to-day. Finally, governments undertook the task of coining money, and, later, when bank-notes came into existence, governments assumed responsibility for safeguarding the public against their misuse. But the power to create credit through the medium of the bank deposit has never, as far as the writer is aware, been assumed by any Government.

The Relation of Credit to Kingship.

There always has been, since time immemorial, a struggle between governments and men of great financial power, because it was realized that control of money, or, rather, control of the power of creating credit, meant control over supreme power in the realm of material things. In theory, kingship should involve the control over all the important forces of the State such as the army, navy, air force, religion, and money, and it would be the control over these things that would enable the king to enforce the law. Most kings or governments control all of these forces, except the power of creating credit. As far as the writer is aware, the great Lama of Thibet is the only official ruler who is banker as well as soldier and priest. It is always stated by those who are supposed to know all about money that governments and kings should

have no say in matters of credit because they are such muddlers. Finance should be left to the experts in the business, viz. the bankers.

The Relation Between Gold and Credit.

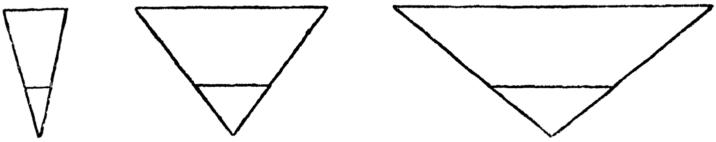
Students of economics should have a clear idea in their minds of the distinction between gold and credit. Everyone is supposed to have such a trust in gold that it has been made the basis of nearly all modern monetary systems. Credit, on the other hand, means the claims to money that people are given by those who possess it, i.e. by bankers and financiers. But the total volume of credit or of claims advanced by bankers to individuals has to bear some reasonable relationship to the amount of the gold which bankers have in their possession. This ratio of credit to gold varies; it is normally from four to six times the gold in the vaults of the banks, but during the War, even in Great Britain, the ratio was many times greater than this. It is very interesting to trace out the story of how the ratio of credit to gold ceased to be a unity, and it is also useful because by understanding this we understand the key to the device for coercing demand. The Bank of Amsterdam is reputed to be the first institution to discover the modern way of creating credit, though doubtless other institutions did the same type of thing. The process was as follows: it was discovered that what one person paid into the bank another person drew out. By omitting these physical operations and by offsetting the debts that people owed each other in the books of the bank much trouble could be saved, and there was a great economy in the use of metal money or of coined money.

A customer could write to the bank and say that he owed Mr. So-and-So, also a customer of the bank, a certain sum of money. All the bank then had to do was to reduce the writer's account and to increase the other person's account, and the debt was paid without the passing of any money between the debtor and creditor, and at a great increase of convenience to every one. At the same time the Bank of Amsterdam came to discover that it could transact its daily business with a much smaller metal reserve. Experience seemed to show that only a 25 per cent reserve on the total of all transactions was required, and so the bank got into the habit of lending credit to people to an amount that was equal to about four times the amount of metal that it had. Other banks followed suit, and thus it was that the deposits of the banks came to be larger, considerably larger, than the gold holdings of the banks. There have been further developments in this policy with the coming of the central banks, but this need not concern us here, though those who are interested in this matter could read about it in Leaf's *Banking*. The important thing to notice is that it is the control of credit and not the control of the note issue or the coinage that matters; and this control of credit is kept away from kings and governments by the bankers.

The Pyramid of Credit.

This is a phrase that is coming into use in financial literature, and it is desirable that we should understand something about it. Sir Edward Holden, of the London Joint City and Midland Bank, Ltd., before it became known as the Midland Bank, Ltd., used to illustrate the

relationship between gold and credit by the use of an inverted triangle, which assumes the shape of an inverted pyramid. It is proposed to copy this illustration of his and to extend it—



Triangle 1 Triangle 2 Triangle 3

The bottom portion of the triangles represents the gold that is in the reserves of the banks, while the upper part represents the credit that is based upon the gold. There are three inverted triangles drawn in order to illustrate the device for coercing demand. Triangle 1 represents a condition of affairs in which the ratio of credit to gold is a low one. Then for some reason it is desired to place more purchasing power units in the hands of the community by an increase of credit, and for this purpose the amount of loans, advances, and overdrafts is increased without increasing the volume of gold in proportion and without, for a period of time, increasing the volume of goods. This is the position that is represented by Triangle 2. Then it is desired to coerce demand even more. So the process described above is developed and more advances are made without proportionate additions either to the gold or, for a time, to goods. This is the position represented by Triangle 3. In a state of affairs such as is represented by Triangle 3 there will be in existence the conditions of a boom, business men will be fully occupied, there will not be much unemployment, and there will be a

general condition of optimism. But there is a catch in this phrase, "coercing demand," because though more money units have been pumped into circulation, like water into a tub, it does not mean that the units of money represented by Triangle 3 have the same purchasing power as in Triangle 2; or that the purchasing power of the units in Triangle 2 is the same as that of the units in Triangle 1. Triangle 3 represents a condition of inflation, and Triangle 1 a condition of comparative deflation, while Triangle 2 represents a condition of affairs midway between the two. It is important to realize that it is very bad to be continually passing from conditions represented in Triangle 1 to those of 2 or 3. It does not really matter at which point the monetary position of the community is stabilized, but it is important that it should be stabilized and kept stable over a long period of time.

Problem 1. Explain what would be the influence of an issue of notes, printed by the Government, upon prices and wages.

Problem 2. What factors are at work to prevent an increase in the volume of goods concurrently with an increase in credit when an overdraft is made?

Problem 3. Which condition of affairs will produce most individual freedom: capitalism under conditions of industrial concentration, or capitalism under conditions of financial concentration?

CHAPTER VI

MONEY

THIS chapter will be important because it deals with money. Some people think that that part of economic knowledge that is concerned with money is unimportant. In a sense this is true; it is unimportant so long as nothing goes wrong with our money system, but once anything goes wrong with it everything is thrown out of gear. Before the War the monetary systems of modern countries were all in smooth working order. Then came the War and they were all thrown out of gear because the bankers, in response to the needs of governments, created bank deposits[1] at such a rate that the level of prices got out of hand, and they are still in that condition. It is no exaggeration to say that the bulk of the world's troubles since the War can be traced directly or indirectly to the fact that the world's monetary systems have for fifteen years been out of gear. So that it is not quite accurate to say that money is an unimportant part of economics. It is a vital part, just as blood is vital to the body. As long as money and blood are in good condition, we do not notice their importance, but once they get out of order the extent to which both are important is soon realized.

Money is the medium into which people turn their goods so as to save themselves the trouble of having to

[1] The Treasury note issue provided the cash basis for this extension of bank credit.

carry their property about with them. In addition to being a medium of exchange it is a store of value. A week's work by a workman is stored, as it were, in the wages that he draws at the end of the week. The money that a person lodges in the bank is, for him, a store of value upon which he can draw at some future date. It is very important that we should be clear in our minds about the function, which money has, of acting as a medium. Speech is a medium of understanding between two people, and it is important that there should be rules of speech, which people may learn, in order that individuals may be intelligible to each other. In the same way and for the same reason, there should be rules of money which people must learn to understand and obey in order that the economic relationship between people may be fair and equable. There are several types of instruments that we call money. The oldest of these types now in use is token money, i.e. coins representing smaller denominations of a larger unit. Pennies and shillings are token money—all fractions of a larger unit, the English pound. Another form of money is the bank-note. Originally it was issued by almost all banks in lieu of gold coins, and its circulation was dependent on the fact that at any moment it could be presented to the bank which had issued it, and its value in metal received. The fact that it was easily convertible made it as good as gold. After 1844 many banks lost the right to issue notes, but just prior to the War and during the earlier part of it the habit of using bank-notes in place of sovereigns began to grow. As the War went on this position was consolidated, and to-day it is customary for the Government

in most countries either to issue the notes or to arrange for their issue by a special institution called the central bank. During the War, however, so many notes were issued by governments to help them to finance the War that the number was out of all proportion to the amount of gold held against them. Of even greater importance was the huge increase in bank credit which, together with the increased issue of notes which enabled it to function properly, was instrumental in upsetting the level of prices. Something had to be done at the first possible moment to induce people to retain confidence in the note issue. After the War, in order to prevent the note issue from getting once again beyond control, Acts were passed in various countries stipulating either that the central bank should retain a fixed percentage of its note issue in gold, or that its note issue should be fixed in amount and that any surplus issue should be secured by gold—pound for pound. Safeguards were also devised to prevent members of the public from demanding gold in return for notes for internal use, and to-day gold is hardly ever seen, it being reserved for international payments alone. With the development of the Bank of International Settlements even this use of it may disappear.

Another form of money is cheques, by means of which people who owe money to other people transfer some of the funds in their banks to the accounts of their creditors in their banks without the passage of any money taking place. When the cheque was first introduced the banks used to employ messengers to go from bank to bank, delivering bundles of cheques which belonged to the various banks but, as the cheque became more popular,

and its use more general, it was decided to establish a central institution, now known as the Clearing House, at which the necessary exchanging of the cheques should take place. At the end of a fixed period, the balances, due by one bank to another, could be settled. The volume of the turnover at the Clearing House is an excellent indication of the amount of business that is being done by the community.

The Bill of Exchange.

Another form of money is the bill of exchange. This is used very much by the business community. The existence of a bill arises in this way. A man sells some goods to another man, who may not want to pay at once, or who happens to live in another country. The seller of the goods then makes out the bill in a prescribed form—setting out the existence of the debt—and sends it to the holder of the goods. This person, if he acknowledges the debt, indicates this by writing the word "accepted" across the face of the bill, returning it to the seller of the goods. If the seller of the goods is in a hurry for his money, he takes it to a bank and gets the bank to discount it for him, i.e. to cash it. This the banker does, but in return for doing this service he charges a small commission, based upon the rate of interest for the period of time that the bill has to run. When the bill becomes due for payment, the banker presents it for payment to the original acceptor. If the business man is not in a hurry for his money, he either waits till the bill is due or else he uses it to pay some of the claims that are made upon him. If he uses it to pay one of his own accounts,

he endorses it by writing his name across the back of it. The receiver of it can then wait till it is due for payment, or he can take it to a bank, or he can use it to pay an account of his own that may be due. Bills of this character are mainly confined to trade and business activity. Money relationships between individuals are normally discharged by token money, notes or cheques.

Summary of Money.

Money is a medium of exchange and a store of value. As a medium of exchange, it takes various forms—the best known of which to-day are token money, notes, cheques, and trade bills of various kinds, either for domestic or international trade.

Now that we know what money is, we pass on to consider the difficult problem of the value of money.

The Value of Money.

Those whose memories go back to the War years may remember that before the War, for the ordinary householder, money used to buy more goods in the retail shop than it does now. What is meant by this is that, if people were in the habit of spending £1 on certain goods, say so much meat, so many vegetables, so much bread, and so on, when they came at the end of the War to spend a similar amount of money, it was found that the quantity of goods received was less, in weight or number, than before the War; and individuals either had to be satisfied with receiving less for their money than they did before the War, or else they had to pay more if they wanted to receive the same quantity of goods. Hence we can see

that money as a medium or as a measure of value is not like a ruler or a tape measure or a set of weighing scales. These methods of measurement, by weight or length, do not alter from one period of time to another, but money, unfortunately, does, with the result that it is almost impossible to keep its value stable. The reason why it changes its value we shall consider in a moment, but before doing this we can consider some illustrations, with advantage, to show how serious a matter it is for the value of money not to stand still. The year 1900 was a year in which the value of money stood very high—let us say that the pound was worth 20/- in its command over goods or services. Let us assume that in that year you lent a man £100 and agreed with him that it was to be paid back again in 1919. In 1914 came the War, and at the end of the War he paid you back your £100, but when you went to spend it in the shop you found that you could only get, say, £25 worth of goods. Is this fair and equable? Or take another case. In 1918, let us assume you lent another man £100, and in 1931 he paid it back to you; when you went and spent it in the shops you found that you got about £140 worth for it. Is this fair and equable? In the first instance, owing to the *rise* in prices your £100 lost three-quarters of its value; in the second, owing to the *fall* in prices it was worth more than it was when you lent it. If a general application of this principle is made, it can be seen what an enormous influence the value of money has on the payment of War debts and on any debt contracted during the War. There are nations which, during the middle and towards the end of the War, had to borrow much money in order

to pay their soldiers, to produce food, and to make munitions. Had these debts been paid back at the end of the War and before 1920 all would have been well, because the value of money in the first few months of 1920 was about the same as it was in 1918. But about April, 1920, there was a general fall in prices all over the world, and the real effect of that was to increase considerably the size of the War debts; that is to say, no difference at all was made in the figures of the War debts—if there had been, people would have noticed what was happening—but, since the purchasing power of money has increased since the War, people have to work harder and be taxed more heavily in order to pay back the money borrowed in 1918, or just prior to that time. The principal people who have avoided doing this have been the Germans and the French. The debt which the German Government owed to individuals from whom it had borrowed during the War was quite considerable, but prices rose so high in Germany that the War debt lost all its value and was, therefore, quite easy to pay off. So when prices fell after the War and most governments found that they had to pay much more to extinguish their debts, Germany had no debt to pay. The French did not allow their prices to go so high as the Germans and, therefore, they still had a debt to pay. But when the fall in prices came after the War, the French bankers and the French Government made an arrangement whereby prices did not fall very much in France, with the result that there was not much change in the value of the French national debt. A French franc to-day is worth only 2d., whereas before the War it was worth 10d. In

1918 it was worth 5d. Hence the French Government has actually reduced the French national debt by more than a half by altering the value of the franc from 5d. to 2d. Recently the British Government protested against this, because Englishmen who had invested in the debt when the value of the franc was high were only getting under half the money paid back to them.

How do Changes in the Value of Money come About ?

We have now to inquire how this value of money can be altered in the manner that has been shown in the above illustrations. This is a difficult thing to explain clearly in a small book of this character. It cannot here be explained in full detail. But the principle involved can be illustrated, and the details and ramifications will have to be left to the fertile imagination of the reader. We must go back to the Triangle illustrations in Chapter V. There it was explained that owing to the fact that bankers are able to increase their deposits by making loans to the business community, they pump units of money into circulation by their action. For example, let us assume that there are three goods in the community and three units of money; then the value of each good is one unit of money—

Example 1—

O	*G*	*O* = units of money
O	*G*	*G* = goods
O	*G*	

If the banking system now decides to increase the deposits in the community, and if this happens without

increasing the volume of goods and if the banking community decides to add three more units of money to the existing store, then there are three units of goods and six units of money, and the value of each good is two units of money—

EXAMPLE 2—

O	*O*	*G*	*O* = units of money
O	*O*	*G*	*G* = units of goods
O	*O*	*G*	

This is an exaggerated illustration and it is, in some respects, defective as an example. But it does serve to illustrate the main principle involved in the change in the value of money. It can now be seen that if in a condition of affairs such as that illustrated by the second example, a huge national debt is contracted, and suddenly the condition of affairs is changed to that illustrated by example one, then two units of money in the second illustration either require twice the amount of goods or twice the amount of service. In other words, the debt has been doubled or very much increased. The change from the conditions of example one to those of example two is generally referred to in economics as inflation, and from example two to example one as deflation.

The Quantity Theory of Money.

This general theory that the quantity of money in circulation in relation to the volume of goods is what determines the purchasing power of money, or, if we put it another way, the price level, is spoken of as the "quantity" theory of money. It is a very famous theory in economics, and is almost universally accepted except

by those who follow the point of view of Laughlin, the American economist. The theory is always in a condition of being re-examined and refined. But the quantity of money and the volume of goods are not the only factors to be considered in endeavouring to comprehend the quantity theory. There is also another element known as "velocity." It does not make very much difference whether there are three units of money in circulation or whether there is one unit which passes so rapidly from hand to hand that it serves the same purpose as three separate units. The rapidity with which money circulates depends mainly upon the habits of the people. Some people carry about much money and very rarely go to a bank; others carry about very little money and are always visiting a bank. The velocity of money in large financial centres is probably more rapid than in small provincial towns; while the rapidity with which money circulates in small country towns is probably greater than in country districts. This factor, velocity, is obviously a difficult one to measure, but it is an element that cannot be left out of account in any discussion of the quantity theory of money, however elementary.

Different Exponents of the Quantity Theory.

So famous and so important a theory of money as the quantity theory is bound to have different exponents. This is, in fact, the case. One form is that in which it is presented by Professor Irving Fisher of the United States, and it is the form in which it is best known. The other form is known as the Cambridge equation because it is the form in which it is used and accepted by the

economists at Cambridge. To discuss these two forms of the equation would take us into very abstruse economics and would also take us outside the scope of this book. Those readers who wish to know more about the two forms of the quantity theory are advised to read Irving Fisher's book *The Purchasing Power of Money*, and Keynes' book *A Treatise on Money*, in which books, particularly in the latter, the two theories are discussed at great length.

Who Determines what the Quantity of Money in a Community shall be?

It has probably occurred to the minds of some readers to ask, if the quantity of money in circulation has such a decisive influence upon the welfare of the community and upon the price level, and hence upon the tone of business, who it is, then, that holds the key to the flood-gates of the monetary supply. This is, at the present moment, probably one of the most important questions that could be asked. It is also a very difficult question to answer. The answer that the majority of bankers would give you, were you to ask them, would be that the volume was determined by the needs of trade. This reply, however, is not quite satisfactory. If by money we mean token money, notes, and bank money, i.e. all forms of money that arise from banking transactions such as bills and cheques, we have, first of all, to inquire whether the country to which we are applying the question has or has not a central bank. Most modern countries have a central bank, but there are still some countries which have not—for example, Canada.

Now the function of a central bank, if it exists in a country, is different from that of an ordinary bank. An ordinary bank is engaged in making profits for its shareholders by rendering the normal banking services to the community. A central bank is not mainly concerned with profits, but it is concerned with the important task of trying to bring about stable monetary conditions. It does this by assuming control of two instruments, namely, the *volume* of credit and the note issue. Of these two powers, that of controlling credit is by far the more important because, by deciding the volume of credit that the banks may have to lend out to the private trader, the central bank really decides what shall be the quantity of money in circulation, because the amount of the note issue and of token money both are themselves dependent upon the volume of credit which has been sanctioned by the central bank. In countries where there is no central bank, the volume of money is determined by the private banks acting either individually or collectively—using their experience as a guide. Whether there is or not a central bank controlling the volume of credit the policy in relation to the volume of credit will very largely be determined by the condition of affairs left in existence by some great world event such as the recent European War (1914-18). The volume of money in all countries has been determined by the enormous quantity of it that got into circulation as a result of the war loans raised; and one of the main tasks in monetary policy *in practice* has been to reduce the volume of money in order to get back to a condition of affairs that existed before the War. One way of doing this—and one that is

being used very widely to-day—is for the central banks and banking authorities to *press for a reduction of salaries and wages,* because if people are short of money then they cannot spend it in the retail shops, and the retailers will have to reduce prices to meet the fall in incomes. The central bankers feel that if retail prices do come down, then there can be a definite reduction in the volume of money in circulation. Whether this is a legitimate policy and whether governments ought to allow central banks to pursue such a policy is a matter which readers can think over in their minds. On the whole, it may be said that the central bankers have succeeded very well in getting prices down towards the pre-war level, but the cost of such a procedure has been the huge volume of unemployment in most countries.

We now have our answer to the question that we asked above, viz. who determines the volume of credit?

Money as a Measure of Value.

Nearly all people who have studied money and its relation to prices have become interested in the problem of maintaining a stable price level and of being able to use money as a yard stick with which to measure value. All sorts of devices have been suggested, one of the most novel of which is the "compensated dollar" of Irving Fisher. No one, however, has yet succeeded in doing this sufficiently well to win the support of the leading monetary authorities. In the meantime the central bankers have set up a world bank, which is known as The Bank of International Settlements, with an international board of directors made up of the central bankers and managed

by Monsieur Quesnay of the Bank of France, assisted by Dr. Hülse of the Reichsbank. What happens in that bank no one but the directors know, but it is presumed that they are endeavouring to reach some agreement upon the most troublesome of the monetary problems. In the meantime it is a coincidence that, just about the time of the establishment of the Bank of International Settlements, the world entered upon as serious an economic and financial depression as it has ever known—a depression that has mystified nearly every one, because in the midst of an unprecedented production of food and of raw materials there is more unemployment and destitution than we have ever known before.

Problem 1. Is it desirable that the political government of a country should be divorced from the responsibility of deciding what the quantity of money should be?

Problem 2. Consider the statement that the control of policy rests with finance.

Problem 3. In what way can the Bank of International Settlements help to produce a stable price level throughout the world?

CHAPTER VII

FOREIGN EXCHANGE AND INTERNATIONAL TRADE

So far, in considering our idea of economic potentiality, and of the elements that go to make it up, we have been mainly concerned with one country, or as some economists prefer to call it, with a closed system. We must now enlarge our ideas and include the whole world in our conception so that the sources of supply of any commodity may be found in any country, and also the market for any commodity. To bring into our discussion any country, other than the one in which we live, is to bring into our consideration the whole question of international trade and foreign exchange, and the whole body of ideas and problems associated therewith. It is now proposed not only to tackle the whole question of international trade, but to spend considerable time upon it because it raises questions of trade policy such as Free Trade and Protection, and—apart from questions of money—there are no problems in which people are more interested at present than in these.

The Theories of International Trade and Foreign Exchange.

We shall begin with the theory of foreign exchange. There are two views of this: the crude or rough view, and the more careful or accurate one. According to the first

view, when a country engages in international trade, its imports should balance its exports and if, for any reason, this does not happen, then gold will be shipped one way or the other in order to make up the balance. If a country's exports exceed its imports, then gold will flow in; if imports exceed exports, then gold will flow out. This is the rough and ready way in which the average person reasons about these things. It is not a very satisfactory way of considering the question because it leaves out of account at least four elements of international trade, which, if included, make a difference—and a considerable difference—to the theory as it is crudely set out above. These four elements are (*a*) loans, (*b*) the manner in which imports and exports are valued (*c*) remittances of various kinds, and (*d*) the effect of the influence of travellers abroad. Elements (*a*), (*c*) and (*d*) are generally referred to under the convenient name of "silent" or "invisible" imports and exports, and perhaps this is why they are so often left out by politicians and public speakers.

We shall therefore take the rough or crude view as set out on the previous page and restate it more accurately as follows: what really counts in international trade is the liability of individuals in one country to individuals in another. If we relate the total claims in one country to those in another then the relative indebtedness of the countries concerned will determine the foreign exchanges.

Having set out the more accurate view, perhaps we had better retrace our steps and explain how invisible or silent imports and exports alter the balance between countries in which we merely consider recorded imports and exports.

Invisible Imports and Exports.

Take first the question of loans by one country to another. Let us apply this to the relationship between Great Britain and the United States before 1873. If we merely add up the imports and exports of the two countries and strike our balance on the result, we shall be leaving out of the account two important items, viz. the loans made by Britain to America over a long period of time—all of which would not be received in goods—and the payment of interest and the repayment of principal. The existence of these two factors would make a considerable difference to the trade balance.

Take next the question of valuing goods which pass in and out of a country. There are many ways in which these can be valued, and it is by no means certain that all countries adopt the same method. Some countries count every unit of goods that leave a port as exports, when they may merely be going to another port just up the coast. There are also problems such as re-exports to be considered, and whether the measuring is done by wholesale or retail standards; while rebates and bonuses create situations in which it is inaccurate merely to count in the recorded import and export figures. Next let us consider remittances. All countries have some of their citizens permanently resident abroad, and these folk often send money home to their relatives in their native land. These payments would not appear in the recorded imports and exports of the countries concerned. In some cases these remittances are a large item, as, for example, in Italy. The Italians resident abroad number about eight millions, i.e. about 20 per cent of the total population.

Next let us think about travellers abroad. Suppose there are 5,000 Englishmen in Italy during Eastertide. They will all be spending money there and will, in consequence, be establishing claims upon England for every unit of money which they require from the Italian banks. This item of claims, which arises in favour of a country having a heavy tourist traffic, is most important in countries like France and Italy.

It can be seen from these examples of silent exports and imports how important they may be in establishing accurately the exact economic relationship between one country and another.

There is still another important point to clear up before we can go forward to our general discussion of international trade. When we talk about a country having a favourable balance of trade, do we mean by this that the day-to-day balance is favourable or that the balance of trade is favourable over a specified period of time?

Whatever we mean, when we come to discuss international trade, we should make it perfectly clear in which of these two senses we are speaking.

The Influence of Gold upon the Balance of Trade.

It is desirable that all students of international trade should understand what is the effect upon a country of an import or an export of gold. Let us take for an illustration the effect of an import of gold into country *A* from country *B* in order to rectify an adverse balance. The first effect is that the balance of trade is corrected. Next, the country which exports the gold should

experience a fall in prices, because the credit which is built upon the gold that has been exported will have to be recalled, thereby reducing the volume of money in circulation, and hence causing a fall in prices unless other factors come into operation to prevent this. In the country which receives the gold, there should be an increase of prices because the increase in the volume of gold received into the banking system will allow an increase in the volume of credit unless anything happens to prevent it. Those readers who find this piece of reasoning difficult, should refer back to the Triangle diagrams where it was indicated how credit was built up on a gold basis. The processes described above are what normally happen, and they represent what used to happen before the War; but, since the War, things are somewhat different. For example, since the War, the United States has received considerable quantities of gold in payment of her claims upon individuals in other nations and upon foreign governments, but rather than use this gold as a basis for credit expansion and, in consequence, a rise in prices, her monetary authorities have chosen to use it in such a way that this rise in prices has not come about. This is one of the most interesting of post-war monetary phenomena. The American monetary authorities have definitely and consciously striven to sterilize the effect of the import of gold, and in this policy they have been successful.

Methods of Redressing Adverse Balances.

Very often those experts who make their living by the purchase and sale of foreign exchange do their best to

control the situation in various ways so as to prevent undue fluctuations in the rates and so as to avoid speculation.

In order to do this they resort to the following three methods—arbitrage, buying forward, and finance bills. We shall not consider these here, but any reader interested in them could read about them in Gregory's *Foreign Exchange*, or in Clare and Crump's *The ABC of Foreign Exchange*.

The Purchasing Power Parity Theory of Foreign Exchange.

So far we have been concerning ourselves with a discussion of the problem of foreign exchange on the assumption that this was decided by the size of the balance of trade, and whether it was favourable or adverse. But there is another explanation, put forward by a Scandinavian economist called Cassel. He maintains that the foreign exchanges are determined by the relative price levels of the countries concerned, and that the rate at which the currency of one country is turned into the currency of another is determined by the relative amounts of money in circulation and their velocity in relation to goods.

The ratio at which these two currencies exchange is known as their purchasing power parity. This name, taken from the ratio, has been applied to Cassel's theory, and it is now known as the purchasing power parity theory. Let us examine an example of Cassel's theory by comparing the currencies of Australia and England which are both reckoned in pounds, shillings, and pence. Let us

suppose that the English pound and the Australian pound have both the same purchasing power, i.e. that they are both worth 20/- in the pound. Then let us suppose that the Australian banks issue so much credit that the quantity of money in Australia is doubled, while that in England remains unaltered, and at the same time there is no alteration in the supply of goods in either country.

According to Cassel's theory it would now take two Australian pounds to purchase an English one—provided there were no other factors to influence the situation. According to the other theory, the rise of prices in Australia as a result of the inflation of the currency would cause English merchants to increase the volume of their exports to Australia to take advantage of the higher prices. This would very much increase the volume of claims upon Australia in England, and this demand would cause in Australia the price of bills to rise until it became cheaper to send gold to England than to pay so high a price for bills. This flow of gold out of Australia would cause prices to fall there, and the inflow of gold into England would cause prices to rise here, and in this way the balance of trade and so of the exchanges would be restored.

On the whole, one is forced to the conclusion that Cassel's theory was a special one, created to meet the special circumstances called into being by the War and war-time finance. With the conclusion of the War, the conditions and the facts upon which the theory was built vanished; and with this disappearance the adequacy of the theory vanished.

Erroneous Popular Notions about the Theory of International Trade.

Before we can go on and consider the history of the theory of international trade, we should get out of our heads certain popular phrases that are used in connection with it—all of which are misleading. The first of these ideas is that international trade takes place between nations. Though it is possible for international trade to take place between nations, and though during the War there was a tendency for nations to indulge in trade with each other, normally trade takes place between individuals in nations; for example, we talk of trade between England and the United States whereas we should talk of trade between individuals in England and individuals in the United States. The second notion of a popular character that it is well to get rid of is that exports are good and imports are bad. Since exports are the way in which people in a country pay for imports, a reduction of the latter would lead to a corresponding reduction of exports. A third idea is that a country that pays high wages cannot export. This is not true. Canada, Australia, and the United States all pay very high wages compared with England and the Continent of Europe, and yet they are all great exporting countries. What is probably meant by this phrase is that a country with a high cost of production finds it difficult to export; this, however, is a totally different thing from saying that a country with high wages cannot export. As a matter of fact, the payment of high wages may mean a low cost of production because the high wages should attract a good stamp of workman who, by efficient work, may produce at a lower cost than

low-paid labourers who are unintelligent and slow. Finally, we should avoid the use of military terms or of naval terms when discussing international trade. Phrases such as "invading markets," "trade barriers," and the like should be avoided.

The History of the Theory of International Trade.

We pass on now to consider, quite briefly, the history of the theory of international trade, because we have not always had such a theory, and when we got one it was not quite satisfactory, and has had to be improved upon. Adam Smith, the first important British economist, who was the author of *The Wealth of Nations*, had no theory of international trade. Ricardo, the next important British economist, developed the idea that international trade was only an expansion of the idea of division of labour, made to apply to countries rather than to people. John Stuart Mill, who followed Ricardo, accepted his idea about the territorial division of labour, but added to it his own idea of reciprocal cost, i.e. that exports were the price of imports and *vice versa*. It was Professor Bastable of Trinity College, Dublin, who first stated the theory of international trade in its modern setting, viz., "A geographic aspect of the division of labour based on compared cost and reciprocal demand."

In this definition we meet the phrase "comparative cost," for the first time, and it is as well that we should understand it because, although in practice, of course, political and other considerations may conflict with economic considerations, it nevertheless lies at the basis of the whole theory of international trade.

The Law of Comparative Costs.

The law is as follows: that countries devote themselves to that form of production for which they are best suited. That is to say, a country may be suited to the production of several kinds of goods and, in fact, it may be able to produce goods of a certain type better than another country, yet, in practice, it does not produce them all. Why not? Because there are some goods for which the country has a special advantage above all others; it, therefore, confines itself to those. We may now look at two mathematical examples of the law of comparative cost, by way of illustration.

Mathematical Examples of the Law of Comparative Costs.

EXAMPLE 1—

Country A produces $1a$ and $1z$ units of goods in 2 units of time.

Country B produces $\frac{1}{2}a$ and $1z$ units of goods in 2 units of time.

Assuming that the law of comparative costs does not operate, and that both countries produce both goods, we find that A and B together produce $1\frac{1}{2}a$ goods and $2z$ goods in 2 units of time.

We now have the countries producing under terms of the law of comparative costs. Then country A will produce a goods alone and country B will produce z goods alone. In 2 units of time we find that A and B, working together, produce $2a$ plus $2z$ goods, which, when compared with the production not under the law of comparative costs, gives us a gain of $\frac{1}{2}a$.

EXAMPLE 2—

Country A produces $1a$ and $1z$ goods in 2 units of time.

Country B produces $\frac{1}{2}a$ and $\frac{3}{4}z$ goods in 2 units of time.

Together they produce $1\frac{1}{2}a$ goods and $1\frac{3}{4}z$ goods in 2 units of time.

Under the law of comparative costs, A keeps to a goods and B keeps to z goods. In 2 units of time there are produced $2a$ goods and $1\frac{1}{2}z$ goods. This gives us a gain of $\frac{1}{2}a$ goods and a loss of

$\frac{1}{4}z$ goods. We have, therefore, to decide the relative values of a and z goods before we can decide whether the law of comparative costs gives us any definite advantage in this case.

It is upon the law of comparative costs that the case for Free Trade rests.

Problem 1. Take any period of time and ascertain whether the rate of exchange between America and England is better explained by the balance of trade theory or by the purchasing power parity theory.

Problem 2. Criticize the law of comparative costs.

CHAPTER VIII

INTERNATIONAL TRADE AND THE HISTORY OF TARIFF POLICY: I

It is going to be assumed in this chapter that readers know something about Free Trade and Protection. What it is desired to begin with is an analysis of the effect of a duty on two different types of goods, viz. an import duty on goods that a country cannot produce, and an import duty on goods that are produced at home. When we have done this we can go on to consider things like bounties, dumping, and methods of combating dumping. Later we can go on to trace the history of tariff policy in the important countries of the world.

The Effect of an Import Duty on Goods that a Country Cannot Produce.

Directly the duty is placed on the goods by the Government of the country concerned, the sellers charge the consumer with the increased duty, and the result is that the goods immediately rise in price by, at least, the value of the duty. If the demand for the commodity is inelastic, i.e. if it does not vary regardless of price, then the effect of the tariff is to make the consumer pay. Next let us assume a case where the demand for the commodity is elastic, i.e. when the price rises the demand falls off. In this case, the seller, who paid the initial tax, cannot recover it from the consumers; he can only recover it from those who want the article sufficiently to

be willing to pay the increased price. Therefore, the increased price will fall partly on the seller and partly on the consumer.

An Import Duty on Goods that a Country Can Produce.

Let us take a more intricate case—that of an import duty on goods which can be produced at home. First, the sellers, having paid the tax to the Government, will add it on to the goods which they sell to the public. If the demand for the goods is inelastic, the consumer will pay the tax ultimately, as he did in the case above. If the demand is elastic, it will fall, and the payment of the tax will be shared by the seller and the consumer, but it will go into the Treasury. If the local producer knows his job, he will extend his production, taking advantage of the protection which the tariff offers. If this extension of home production under the shelter of the tariff has the effect of driving out foreign competition, then any enhancement of price, less than the tariff, which the consumer pays, goes not to the Treasury but to the seller. If this happens, then the State concerned loses the tax, the consumer pays more, and the seller gains. Theoretically, it is possible that the industry may go on expanding so that there may result the advantages of large scale production, i.e. a reduced price. It may happen that the industry, being in a strong position, may gain first place in the foreign market, reducing the price of the article there but not in the home country. If this happens, then the benefit of the low price goes to the foreign consumer and not to the home consumer.

Bounties.

This brings us to the question of bounties and of dumping. The only difference between a bounty and a tariff is one of method. The two main effects of the bounty are: first, the producer can sell cheaper than his competitor and fear no loss because the bounty makes that up to him; second, it enables the producer to venture into foreign markets, underselling his competitor there, because of his knowledge that the bounty will make this possible for him without economic loss. The country which used the bounty most as an economic weapon before the War was Germany, and it was largely instrumental in helping her business men to build up her foreign trade.

Dumping.

Dumping means the sale of goods abroad at a cheaper rate than the price realized at home. J. A. Hobson, the English economist, classifies dumping under three heads, as follows—casual dumping, aggressive dumping, and permanent dumping. These names clearly describe the forms of dumping so that no more need be said on that score; we may perhaps venture to add that there are few cases of permanent dumping known to have occurred, and that of the dumping nations, England has, in the past, been the greatest offender.

Some people favour dumping because, however much it may hit competing producers, it does give the consumer a cheap price. This point of view is not the normal one, and, at the end of the War, most governments took

review falls into three sections: first, that from 1815 to 1826; second, that from 1826 to 1865; and, third, from 1865 to 1914. The great economic struggle that lay underneath the military struggle between England and France decided the French Government after the Napoleonic wars, that the only chance for French importers to be able to compete with the post-war inflow of English goods was to give her producers Protection. Within eleven years of the conclusion of the war, i.e. by 1826, the economic interests of France had definitely set their faces in the direction of Protection, and once the step was taken there was no turning back.

In the second period of French tariff policy (1826–65), the very great success of England under Free Trade, and the influence of the leading men, who were continually passing between the two countries, weakened the position of Protection in France, and there developed a movement in favour of Free Trade. In 1860 England and France actually negotiated a Free Trade treaty.

The third period of tariff policy (1865–1914) opened with two wars, one in 1866 and another in 1870. The effect of these two wars upon France was to throw her in the direction of strong Protection. In 1881, however, the tariff was reduced slightly, and from 1880–90 the experiment of protecting agriculture was tried. In 1892, a maximum and a minimum tariff were established, though the maximum tariff was abolished in 1910.

GERMANY

Directly we come to study the tariff policy of Germany, we meet with the personality and work of Frederick List.

No one can hope to understand the case for Protection until he has read and mastered List's book, *The National System*. The importance of List lies in the fact that, though he was a German, he spent much of his time in America, where he came under the influence of Hamilton and of the American manufacturers. What he learned in America he determined to apply to Germany, and it is herein that his contribution lies. He was the first to apply American experience to Germany. His influence, at first, was not very great, but, as the century advanced, and the rival theories of Free Trade and Protection, supported in each case by massed economic interests, came into hot dispute, List's work was more and more recognized, and his book was very widely read.

The Ideas of List.

List's ideas upon the general subject of Protection were as follows. He recognized, as we all do, the importance of nationality in industry, that French people should buy French goods, that British people should buy British goods; that in building up national industries in the various countries, and by giving employment to nationals in national factories making national goods, it was possible to mobilize the sentiment of a nation behind an industry. List then went on to point out how important was productive capacity in a nation—over-specialization upon one or two or on a few industries did not give a nation a balanced economy; what was wanted was a policy whereby the whole of the productive capacity of a nation might be called upon to serve in the great and general scheme of national production. He pointed out that the

real reason why the United States seceded from Great Britain was because the right to manufacture her own products was denied to her by Great Britain. In the judgment of List it was only the grant of fiscal self-government to Canada, Australia, and New Zealand, thereby placing them in a position to manufacture their own products, that had prevented them from following the example of the United States. List then goes on to point out in his argument that nations pass through various stages of development and that, as they pass through these stages, they need a special economic system. Nations began their life, he said, in a stage of economic barbarism; from this they passed into the pastoral stage, and from this into the agricultural stage. Then from this more advanced stage a nation passed into the agricultural-manufacturing stage. From this it passed into the final stage, which List called the agricultural-manufacturing-commercial stage. For each of these stages, said List, a special tariff policy was necessary. For the first three stages Free Trade was desirable; for the fourth Protection was desirable; and when a nation passed into the fifth, it was desirable to return to Free Trade. Hence, the problem for the statesman who was concerned with the question of tariff policy was to decide in which of the above five stages his country was. Germany at the time List wrote was in the fourth stage, and hence it was that List advocated Protection for her. England was in the fifth stage, having passed out of the fourth about the time of Adam Smith, and hence Free Trade was better suited to her.

It is, perhaps, most important to point out that List

was not a rigid Protectionist. To him Protection was only a temporary expedient in which to indulge solely for the purpose of encouraging manufacture; and the purpose of using Protection to develop manufacture was in order to obtain national productivity and to make all courses of wealth contribute to the national well-being. The imposition of Protection was not to be a mechanical prohibition to be applied generally: on the contrary its application was to be specific and temporary and need not be made to apply to all branches of industry equally.

The Precise Contribution of List.

Before we leave our consideration of List, and before we pass on to follow the general story of tariff policy in Germany, it will be useful to have clearly in our minds the precise nature of the contribution to the whole theory of Protection which List made. In arguing against the logical extension of the law of comparative costs until a nation became a highly specialized industrial unit with all its national vitality banked up behind the selected forms of specialization, List was on sound ground. It is far better for a nation to spill its productive energies into every channel of economic activity than to concentrate them upon a few. But in conceding this point to List, it must be remembered that in this general development and the economic balance that comes with it, the level of economic wealth cannot be as high as when a nation, in its production policy, obeys the law of comparative costs. This is the weak spot in List's argument, viz. that in order to obtain all-round productivity and a better balance of a nation's activity,

national wealth is sacrificed somewhat. Nor should it be forgotten, in endeavouring to appraise the work of List, that he developed quite an inordinate admiration for manufacturers and their doings. Those of us who have had the advantage of seeing a manufacturers' civilization develop are in a better position than was List to weigh up its strengths and weaknesses.

The Tariff Policy of Germany.

The story of the development of the tariff policy of Germany falls, as with other countries, into three periods; first, that up to 1840; second, from 1840 to 1870; and, third, from 1870 to the present day. In connection with the first period, it has to be remembered that Germany was a series of small states, eaten up with animosities, petty jealousies and economic discriminations. In 1834, after considerable agitation, there was established the Zollverein, i.e. an economic union of all the German states, though it was not accompanied by a political union—that did not come till 1870. This Zollverein involved a tariff for the whole country and Free Trade between the states. In deciding upon a uniform tariff to be applied to all outside goods, the other states accepted, as a model, the tariff in existence in Prussia.

Protection, Wars, and Religion.

Having thus attained some form of national economic union, through the medium of the Zollverein, Germany then had to face the problem, which all protectionist countries have to face, of harmonizing the interests of industry and agriculture; the north was agricultural,

and the south was industrial. There were four important factors influencing the situation; these factors were the competition with England, the competition with Russia, the demands made by Austria, and the three wars of 1860, 1866, and 1870. At the conclusion of the war of 1870, England, America, and Russia began to dump goods into Germany; while at the same time the conflict of religious interests—Catholic versus Protestant—threatened to split the State in twain. Bismarck, therefore, decided to kill two birds with one stone; he imposed Protection to prevent the dumping and to satisfy the demands of the manufacturers, and, at the same time, by raising a major economic issue, he cut across religious differences. Economic advantage drove Catholic and Protestant agriculturists into each other's arms, and fear of Free Trade united Protestant and Catholic industrialists.

Bismarck not only protected industry, but agriculture also, for he was not in the position of England, which country if it protected agriculture would offend its colonies and dominions.

Protection and the Versailles Treaty.

Germany remained protectionist till the adoption of the Versailles Treaty, which robbed her of her sovereign rights in respect of tariff policy. This was part of the Allies' organized effort to keep Germany in economic subjection—a policy which, as we saw, was begun at Paris in 1916. Under the Versailles Treaty, Germany was prevented from exercising discrimination against Allied goods. Under Articles 264 and 266 of that Treaty

any import privileges granted to one Allied power must be granted to all. For five years the goods from Alsace-Lorraine were to go into Germany free; while for three years goods sent from Germany to Alsace-Lorraine, and re-exported, were to be free of customs charge. The two sets of provisions that were made to apply to Alsace and Lorraine were made, also, to apply to Poland and to Luxemburg. The Allies also reserved special rights to be applied to regions occupied by Allied troops, while the goods of Allied countries passing through Germany were to be free of customs dues. These provisions remained until the adoption of the Dawes Report in 1924, when the rigour of some of the conditions was modified.

Problem 1. Classify each of the following countries into one of the five divisions that List uses: Greece, Italy, Arabia, India, Egypt, Japan, China, Peru, Patagonia, New Guinea, New Zealand, and Cuba.

Problem 2. Set out what you consider to be the advantages and the disadvantages of a manufacturers' civilization.

CHAPTER X

INTERNATIONAL TRADE AND THE HISTORY OF TARIFF POLICY: III

WE now go on to ascertain the facts of the story of the development of tariff policy in the United States. Readers who wish to follow this story more closely should do so by reading the works of Hamilton, Carey, and Patten, who are the main American authorities. As with France and Germany, the story falls into three periods: the first one ends with the outbreak of the Napoleonic wars; the second one runs from the time of the Napoleonic wars to the initiation of the McKinley tariff in 1889; and the third extends from 1889 to the present time.

UNITED STATES

The initial interest of the people of the United States in tariff policy arose with the tariff restrictions which the British Government, acting upon the principles of mercantilism, placed on the colonies. British statesmen did not seem to be able to explain to the colonists the Imperial point of view that, if they desired protection against the French in Canada and elsewhere, or against the Red Indians, this protection had to be paid for, and paid for out of taxation. On their side, the colonists did not seem able to explain to the Imperial authorities that, though they were willing to pay for their defence, they did not

wish that the taxation imposed to meet this expense should become a means of restricting the development of their local industries. This misunderstanding ended in war and destroyed the first British Empire. When the colonists, aided by the French, won the war which wrecked the Empire temporarily, the tariff question became an important one for the young independent colonies. and in 1789 a moderate tariff was imposed.

The Influence of the Napoleonic Wars on American Tariff Policy.

With the outbreak of war between England and France—the Napoleonic wars—and the consequent destruction of commerce and the existence of naval restrictions imposed by the nations at war, there was a natural Protection afforded to the United States. Finally, as a result of Britain's interference with her commerce, the United States joined the war on the side of France against Great Britain. This cut off all trade between the two countries. In 1816, after the conclusion of the war, the United States was deluged with goods from Great Britain, and this led to an increase in the amount of the protective duties—an increase that lasted for about twenty years. There were, however, reductions in the amount of the tariff, viz. in 1832, 1846, 1857, and 1860. Shortly after this came the slave war between the North and the South—a war, which, at the back of it all, was a war between agriculture and industry for the right to determine the tariff policy of the country. The result of the war was a victory for the North, and this meant a victory for the economic interests of northern industry—a victory for

Protection. The political parties crystallized themselves round the tariff policy, the Democrats adopting Free Trade and the Republicans Protection, the former supported by the farmers, and the latter by the industrialists. Then the Republicans imposed the McKinley tariff, which has been referred to above. The purpose of this tariff was threefold: the defence of the home market, the maintenance of high wages, and resistance to the inflow of goods from Canada.

The Trust Movement, the War, and the Tariff.

In 1894 the Democratic party was returned to power, and it at once attempted to reduce the level of the tariff by trying to impose the Wilson tariff. This was rejected owing to the strong pressure of business interests, and the growth of the trust movement, which found in the tariff a great aid to its development. The Democrats did not come back into power again till 1913, and whatever plans they had for the reduction of the tariff were frustrated by the outbreak of the European War in 1914. When the War was over, its effects upon tariff policy were just the same as in Europe, viz. to encourage the idea of economic nationalism in industry. In 1921 the Republican party imposed the Fordney tariff—one of the highest tariffs that the world has ever known.

The Lessons of Tariff Policy in the United States.

There are two lessons to be learned from following the history of tariff policy in the United States. The first lesson is this—that there is an enormous advantage to be

derived from having a tariff wall round a huge area in which there is domestic Free Trade—for the United States constitutes the largest Free Trade area in the world. The second lesson is pointed out to us by one of the leading American economists, Taussig. He tells us that it is necessary to combat the view that the prosperity of the United States depends on the tariff.

AUSTRALIA

We turn next to consider the history of tariff policy in one of the British Dominions where one would have expected that the trade theories of the mother country might have found some support. The story falls into three periods: first, that in which the colonies were dependent on the mother country; second, the colonial period; and, third, the Dominion period.

Mercantilism and the Durham Report.

Up to the year 1846 Australia, in her tariff policy, was subject to the influence of mercantilism; that is to say, she was organized, economically, so as to exist for the material well-being of Great Britain. With the repeal of the corn laws by Sir Robert Peel, the Australian colonies accepted Free Trade. It is important, in connection with the relation to tariff policy of the growing desire of the colonies for self-government, to bear in mind the influence of the Durham Report. This important document set out the accumulated wisdom of the British Empire upon the whole question of the future government of the colonies—an important aspect of which was tariff policy. The Report recommended that the decision

about what form of tariff policy the colonies were to adopt should be left with the Imperial Government. Fortunately for the second British Empire this provision of the Durham Report never received practical effect in the relations between the mother country and the colonies; and all of the colonies, when they received self-government, were also given self-government in respect of tariff policy. The first colony in Australia to take advantage of the freedom to choose a policy other than that pursued by Great Britain was Victoria, which colony, receiving self-government about the middle of the century, adopted Protection as her tariff policy in 1860. There were in Australia, and in Victoria, two groups in the tariff controversy. The Free Trade group consisted of the large landholders, the bankers, the importers, and the consumers. The Protectionists were made up of the manufacturers and the workers in the factories. Victoria continued to re-affirm her belief in Protection—largely through the influence of a very powerful journalist, named David Syme. When, however, the Australian states agreed to federate in 1900 under the title of the Commonwealth of Australia, it was realized that the spirit of economic nationalism, which had brought about the federation of the states, would not support a Free Trade policy in the Federal Parliament. And so it proved. In 1902 the first tariff was imposed; it was only a revenue tariff, however. In 1908 proper Protection was introduced by the Deakin Government, and from that date onwards the Commonwealth was committed to full Protection. After the War, as a result of the special stimulus given to the spirit of economic nationalism by

the War, and as a result of the natural Protection which the War afforded Australia as it had the United States a hundred years earlier, the level of the tariff continued to rise. It was of three types, low, intermediate, and general. In 1929, owing to exchange difficulties arising from the fall in the price of Australian wool and lack of funds in London, the Australian Government, in order to discourage imports, and so as to accumulate funds in London, raised the tariff to unprecedented heights, and it now remains in that position.

The Lessons to be Learned from Tariff Policy.

Having now traced, in necessarily brief fashion, the story of the development of tariff policy in the main countries of the world, we are in a position to be able to abstract from the facts some of the lessons to be learned. In the first place, we may say that neither Protection nor Free Trade is a matter of principle; some countries do well under Free Trade, and others do well under Protection. Secondly, it is fairly clear that economic theory, in these discussions, counts less than economic interest, and if manufacturers want Protection, and are strong enough to enforce it through the operation of their economic power in the realm of politics, then Protection will be adopted, regardless of the economic facts of the case and of the theories based on these facts. Thirdly, the question of tariffs for purposes of revenue appears to be of secondary importance. Fourthly, violent controversy, based upon economic interests, has undoubtedly exaggerated the importance of tariffs in national politics. Fifthly, it is important to realize that national welfare and national

progress depend on factors other than the tariff. Sixthly, it should be realized that in subjecting the national economy of a country to a change from one policy to another, there is bound to be a huge wrench given to the national system of industry; all types of repercussions are bound to appear during the period of transition, and any one of them may be disastrous.

The Case for Free Trade.

Having now abstracted from our historical material six points of importance, we may turn to consider, briefly, the Free Trade case. It is quite a simple one. In general, civilized society is to be allowed to do what it likes until there is advanced a sufficient reason why it should not. The advantages which arise from the international application of the principle are that, when nations concentrate upon the production of goods for which they have a special advantage, there is an improvement in dexterity, there is a saving of time, and there is the saving effected by the use of machinery. These savings give a greater output of wealth while, at the same time, they save the community from the annoying unpleasantness of Protection.

The Case for Protection.

Against this, on the side of Protection, it is argued that a young industry, just opening up in a community, does deserve protection before it is crushed by the economic power of well-established rivals. This is the famous infant industry argument. The Protection argument then proceeds—that diversity of manufacture

increases a nation's productivity and that, in times of war, it is desirable to have all of one's industries within the political boundaries of one's own country. Moreover, the act of beginning new industries not only gives a country a diversified economy; it also has the general support of national sentiment. There are also other arguments used to support the protectionist case, but they are of very doubtful economic value—for example, that Protection raises wages, attracts capital, and keeps money in the country.

The Reply of Free Trade.

To all this the free trader replies that Protection causes wars by making nations indulge in uneconomic competition, whereas under Free Trade each country produces that for which it has a special fitness; if actual war does not arise, says the free trader, then there is a tariff war; in countries where there is Protection there is considerable political corruption because manufacturers use their economic power to induce politicians to do their bidding; this corruption may take any form from donations to the party funds up to direct bribery. Further, Protection does two things which any decent country would like to try to avoid, viz. it induces inefficiency by granting to producers the tariff wall behind which they may shelter, instead of compelling them to stand up to the full blast of economic competition and, thereby, to test their efficiency by comparison with their rivals. Protection also fosters monopoly by creating conditions in which it can exist; Free Trade countries do not produce a monopoly unless it be a monopoly due to efficiency.

Additional Remarks on the Foreign Exchanges and Monetary Policy.

Before concluding this chapter, it is desirable to add something to what has been said about the foreign exchanges. Since we have already learned something about inflation and deflation, and since they play so important a part in the post-war exchanges, the terms are going to be defined so that the reader will always know what is meant by them. The definition of inflation that we shall use is that adopted by the Federal Reserve Board of the United States, viz. "the process of making additions to credits not based upon a commensurate increase in the production of goods." The definition of deflation that we shall use is the one adopted by Cassel, the Scandinavian economist, viz. "A means of increasing the internal value of the money unit." It is proposed to review, briefly, the history of monetary policy since the conclusion of the War. As we know, all countries financially associated with the War, save Sweden, whether on a gold standard or not, seriously indulged in inflation during the War; this arose as a direct result of the action of the banks and financiers in making enormous additions to credits not accompanied by a commensurate increase in goods. When the War was over, the bankers continued this policy until 1920 when, after consultation amongst themselves and with the governments concerned, it was decided to deflate with the object of getting back to the gold standard and of raising the internal value of the monetary unit in each country. On the whole the bankers have succeeded in their policy because the major countries have returned to the gold standard, and the price of wholesale goods, *though*

not of retail goods, is back where it was before the War. This is one side of the picture. But this policy of deflation, while it has suited the banks, insurance companies, and others who had invested their money, towards the conclusion of the War, in war loan, by placing them in a position to get more for their loans than they lent originally, has meant the ruination of many business men, stagnation of business, and a volume of unemployed the like of which the world has never seen before. At the same time the suicides and the bankruptcies have increased beyond measure. A graph has been drawn of the suicides and bankruptcies in England since before the War and continued up to, approximately, the present time, and, whereas, during the War, both suicides and bankruptcies almost disappeared, when the end of the War came, and the banks enforced the policy of deflation upon the business community, the numbers of bankruptcies and of suicides in the graph *went up by hundreds per cent.* So when we look at our return to the gold standard and at our low commodity price level, let us not also forget the ruined businesses, the misery of the unemployed, and the huge increase in the bankruptcies and suicides. This general debacle in the world's financial affairs began in Japan, and then spread steadily from country to country all over the world. About 1922 the bankers held their hands and, for a period, we had a return to slight inflation, but then a return to deflation was made. On the whole, ever since 1920, there had been a steady process of deflation in operation. All this has upset the exchanges, and various devices have been suggested for remedying the general state of affairs. To follow these through in detail would

make this chapter too long and might confuse readers. Those who have a taste for the complexities of foreign exchange can, if they wish, try their teeth on Gregory's *Foreign Exchange*, where the details are set out in full.

Problem 1. Can you account for the fact that, though wholesale prices have fallen since the War, retail prices have not fallen nearly so much?

Problem 2. What do we mean when we say that tariff policy is not a matter of principle?

CHAPTER XI

WHO OWNS THE EXISTING WEALTH?

We have now completed our consideration of the whole question of international trade and its related problems. This completes the general picture of the economic machine at work mobilizing potentiality in all its aspects in all countries, rendering labour efficient, storing up extra effort in the form of capital, assessing wants, coercing supply and demand.

The Distribution of Wealth.

We now come to what, probably, readers will regard as the most vital and interesting part of their studies, albeit, too, the most controversial. We come now to consider the piles of goods that labour, working on land, has produced, and we want to know where all these goods go, who gets them and how much each person gets. In other words, we want to know how the wealth of the community is distributed, i.e. we are now concerned with the problem of the distribution of wealth, and its effect upon the policy of production and upon the nature of production. We can best secure a picture of this by getting the statistics of wealth distribution of certain countries before us. It is proposed to examine two sets of figures for England, one for the United States, one for Germany, and two for Australia.

The Principles Underlying the Distribution of Wealth.

Before actually looking at the figures, we can, with advantage to ourselves, consider some of the principles underlying the distribution of wealth. We are faced with two essential principles—that of compulsion and that of inducement. That is to say, we can either compel people to take part in the process of production, and then issue them with ration tickets entitling them to draw necessaries from the common store, or we can adopt another method. The other method—that of inducement—is one by which we offer people a claim upon the community's production in return for their services, and, in theory, the more work they do, the more claims do they get, and the more claims they get the more do they become well-to-do. Associated with these two ideas of wealth production, we have two others which are complementary to them. The first is the old Biblical phrase which runs to the effect that he who does not work shall not eat, i.e. if a person will not help in the processes of production, then he should not be allowed to share in the fruits thereof. This phrase has been seized upon by people who give their support to two different sets of ideas—the capitalists and the workers. The former use the phrase when they think of the good-for-nothing scamps who will not work, and who do not want to work; the latter use the phrase of the fat and sleek employers who are conceived as occupying comfortable chairs, doing no work, and drawing their dividends from the wealth that the horny-handed sons of toil produce. Unfortunately, neither of these applications of the phrase is an accurate

picture, because as the result of science, invention, and education we now produce considerably more goods in eight hours than we used to in fourteen, and we are seeing before our eyes a process at work whereby the work of the world is being shifted off the backs of men and given to machines. This has produced two curious results: first, it has led the working class to set up a demand for a right to some of the world's work in order that money may be earned; and because of the enormous number of unemployed since the War, it has led to the distribution of a kind of dividend to those for whom no work could be found—and this dividend for being unemployed goes, in different countries, under various names such as "unemployment insurance" or "the dole." Somehow or other, people do not seem to be able to accustom themselves to the idea that there is not nearly enough work for every one to do, and that, in order to get rid of the surplus produce of the combined efforts of those who *do* work, income is being given away for nothing.

Generally speaking, we are still living in an age of production by inducement.

Figures for the Distribution of Wealth.

We may now look at some of the figures of wealth distribution—

(*a*) Chiozza Money in 1911 estimated that in that year 88 per cent of the people of England received 51 per cent of the national income, 9 per cent received 15 per cent of the income, and 3 per cent received 34 per cent of the income. By combining two of these sets of figures, viz. the first and the second, he was able to show that 97 per

cent of the people got 66 per cent of the income, and that 3 per cent got 34 per cent of it.

(*b*) In the same year Professor Bowley, of the London School of Economics, estimated that the total wealth of the United Kingdom was £2,090,000,000. People's incomes under £160 a year totalled £1,096,000,000, i.e. 52·5 per cent; while people's incomes over £160 totalled £994,000,000, i.e. 47·5 per cent of the whole.

(*c*) In the United States, Professor King, the American statistician, estimates that the poor (i.e. those with incomes under £240 a year), comprise 82 per cent of the people, and they receive 55 per cent of the income. The middle class (whose incomes are between £240 and £800) comprise 16 per cent of the people, and they receive 25 per cent of the income. The rich (those whose incomes are more than £800), comprise 2 per cent of the people, and receive 20 per cent of the wealth.

(*d*) In Australia, the so-called working man's paradise, the wealth census of 1915 revealed the following state of affairs—

Those whose incomes were under £200 a year comprised 90·3 per cent of the people, and they received 60·4 per cent of the wealth. Those whose incomes ranged from £200 to £1,000 comprised 9·1 per cent of the people, and they received 27·6 per cent of the wealth. Those whose incomes were over £1,000 a year comprised .6 per cent of the people, and they received 12 per cent of the wealth.

(*e*) Mr. Sutcliffe, formerly a member of the Australian Bureau of Census and Statistics, who has now entered the business world, gives additional statistics for Australia. They appear in his book, *The National*

Dividend. In the year 1920–21 (July to June), 58·7 per cent of the Australian bread-winners received less than £200 a year. In the same year 64 per cent of the bread-winners received less than £500 a year. In the same period of time 4·36 per cent of the income-receivers received 21·76 per cent of the total income. In the same time 21·75 per cent of the private wealth of Australia went to wage and salary earners. In the same period of time 78·25 per cent of the private wealth of Australia went to people other than wage and salary earners.

(*f*) It has not been possible to secure very satisfactory figures for Germany, but in Prussia, in 1911, 90 per cent of the receivers of income earned less than £150 a year, and this was about 60 per cent of the total Prussian income.

Comments upon these Figures.

It may be possible to criticize these figures in various ways and to cast doubt upon their absolute accuracy, but, on the whole, they have been compiled by competent statisticians, working upon as reliable data as it is possible to get about matters which are of such a confidential nature as personal income. These figures do not tell us much, but they do indicate in a general way what the distribution of wealth is in four different countries. We can say the following three things about these figures without serious fear of contradiction, viz. (*a*) that in both old and new countries, the poor make up 90 per cent of the population, (*b*) that the poor receive about 60 per cent of the income, (*c*) that the remaining 10 per cent of the people receive 40 per cent of the income.

Is a Re-distribution of Wealth Desirable or Worth While?

While we are considering the statistics of wealth distribution, we can settle two points that have bothered people for many hundreds of years. These two points are, first: would not every one be better off if those with incomes above, say, £180 a year had them taken away from them, and if the surplus were divided equally amongst all? The second is the contention that the world is all right as it is, and it does no good to disturb men's minds about the distribution of wealth. In regard to the first question, the English statistician, Bowley, has actually made a calculation, dividing out the surplus wealth of England on paper, taking about £180 per annum as a basis for computing his surplus. He found that, if the incomes of England above that sum were divided out evenly, the result would increase the weekly earnings of every one by 10/- a week or £26 a year. If we consider the amount of bloodshed involved, and other disturbances created by such a confiscation of wealth, it does not seem that the ultimate result—an extra 10/- a week—would be worth all the fuss and bother.

Coming to the second question—whether we should sit down with resignation and accept the situation as it is, it is hard to think of any legitimate argument in favour of that point of view. The mal-distribution of wealth is undesirable on grounds of social justice; it is equally undesirable on grounds of the efficiency of production, because were the poor population of the countries of the earth to become wealthier by an increase in the purchasing power of the money units which they hold, it is quite

certain that this additional effective demand in the hands of the 90 per cent of people would lure out of the productive resources of the community more wealth than is actually won now. There is very little doubt that reserve power is waiting there to be stimulated, but such reserve power cannot be stimulated when it is known that the markets of the world are glutted with food products and with raw materials, which no one can afford to buy except at a price that would not give the producer anything like a fair return on his money. This being so, there must be something wrong with the view that distribution by inducement gives to the people the necessary tickets or money with which to buy the whole of the goods that the economic machine produces. This plainly cannot be, because somehow or other these tickets appear to be accumulated, ultimately, in the hands of those other than the general body of consumers. At the same time the shops are full of goods, and a quite inordinate amount of human effort is devoted to advertising and salesmanship. This suggests that the market is glutted with goods over and above what the consuming public can afford to buy.

Is there General Over-production ?

But this is a superficial way of putting the situation. Stated in this general way, the theory that there is general over-production of goods throughout the world is equivalent to saying that the expansion of human wants has come to an end, and that they cannot be expanded any farther. This is surely inaccurate. If we look at the problem from the point of view of the poor

person with an income of under £150 a year, it is absurd to say that all his needs are satisfied. He simply has not the money to spend on the goods that he would like to buy. The existing goods have been produced in accordance with a certain set of rules, one of which is that a unit of production, before it can be consumed, must, in the price that is paid for it, repay the conditions of the cost of production in existence at the time it was made, even though there are consumers who badly need that unit of production though they cannot afford to pay the price demanded for it, just as the owner of the goods cannot afford to let the unit of production go for under what it has cost to produce, even though the unit of goods is left on his hands. This is one of the most baffling of the problems of modern industry, and it raises for our consideration the whole question of costs and prices. This question of costs and prices has been receiving in America and in England considerable attention from informed people, who, feeling that physical science has in one way or another built up a producing machine of very great efficiency, are mystified by the paradox of shops full of goods alongside unfed unemployed and a huge body of under-nourished poor.

This problem of the true cost of an article and the set of conditions governing it is of the utmost importance in economics, and we shall return to it again.

Problem 1. Discuss the limits of the phrase that "he who does not work shall not eat."

Problem 2. Is the world materially poorer since the War?

CHAPTER XII

REFLECTIONS ON THE MAL-DISTRIBUTION OF WEALTH

THIS is a convenient place at which to revise our ideas and to refresh our memories on the whole question of the distribution of wealth, and its influence upon the production of goods and services.

Let us remind ourselves that a firm, besides performing its ordinary function of converting goods in process from one form to another, is also engaged, though it does not realize it, in distributing units of purchasing power to the community in one way or another. It distributes dividends to shareholders once a year, it distributes salaries to professional officers of the firm once a month, and it distributes wages to the labourers once a week. Interest is also paid to some bank or to some individual who has lent the firm money.

A government department when it pays wages and salaries acts in the same way as a private firm, except that it is really distributing as wages and salaries the incomes which people actually possessed at one time or another, but which have been taken away by taxation.

Banks also Help in the Process of Distributing Purchasing Power.

We, normally, think of a bank as an institution which gathers in money, but banks also act as agents for the

distribution of purchasing power to the community, just as other firms, i.e. they pay profit, interest, salaries, and wages, but they also contribute to the process in another way which should claim our attention for a moment. For example, firms which are not in a position to pay wages and salaries very often borrow from the bank, and the overdraft, loan or advance, which is obtained, enables them to distribute to the community wages and salaries which soon re-appear in the banking system as deposits.

During a war and, sometimes in a period of peace, governments may be hard put to it to find funds, and they yield to the temptation of printing notes to meet their obligations. This practice of printing notes has much the same effect as the issuing of overdrafts, loans, and advances. If the issue either of paper money or of credit makes additions to purchasing power not commensurate with the increase in the production of goods, then there is inflation and a fall in the command over goods which the wages, salaries, and dividends, that have been distributed, possess. Very few people realize that, in some form or other, the alteration in the purchasing power of their wages, salaries, and dividends is going on quietly all the time.

The Influence of Wealth Distribution on Welfare and on the Policy of Production.

We have next to inquire what influence the distribution of wealth has upon the general economic welfare of the State and upon the intention of producers. Producers will make goods for that section of the community which

possesses wealth, and a realization of this fact gives an immense amount of economic importance to the 10 per cent of the people who, as we saw in Chapter XI, own 40 per cent of the wealth. These people possess two-thirds of the power of the remaining 90 per cent of the people. Banks, as the financial dynamos of the community, will furnish credit to those firms which can recover their costs of production quickly; and hence many firms would rather concentrate their attention on making goods for the 10 per cent of the community who are well-to-do than for the 90 per cent who are not. Though bread and meat continue to be produced regularly because there is a certain demand for them, there is a tendency for credit and capital to be made available for the production of luxuries which pay well rather than for the production of non-luxuries. It is surprising what an amount of money there is made available for the creation of goods which meet the demands of people who go in for hotels, picture shows, and racing, instead of being made available for education and for homes for working men. The reason is that there is a quick return on capital and credit put into the first type of goods, and a slow return on the capital and credit that is put into the other form.

Some Questions to Answer.

A deduction made from this conclusion leads us to suggest that the wholesome needs of the community may not be financed at the same rate as the unwholesome needs, on the ground that the latter pay better. Is this sound economy? The answer to this question brings strongly under our notice the question that was asked

in Chapter I, viz. whether or not economics was concerned with morality and ethics. This leads us to ask whether economics can furnish an answer to the following group of questions—four in number. Should a wisely directed economic system allow any one to have cake before any one has received bread? Should wealth be fairly evenly distributed? If wealth were re-distributed, would not the inequalities re-appear quite soon because of the inequalities in human nature, i.e. because different people possess different abilities? Should the machine for the distribution of wealth be left as it is, be adjusted, or be destroyed and a different one created?

To attempt to answer these questions brings us to the most exciting part of economics—to that portion of it in which almost every one is interested, almost without being aware of it. Some economists prefer to avoid discussing this portion of the field of economics because it stirs human emotions so much and because it verges so closely upon the sphere of politics. Neither of these can be considered sufficient reason for omitting to discuss that portion of economics which has really a vital interest for every one. Politics and economics have become so closely interrelated and interwoven that the contribution of economics to politics is more than ever necessary. Let us remind ourselves of a remark, written in the first chapter of this book, to the effect that economics is a method of thinking about certain problems, i.e. it is an instrument of thought—an instrument of thought which should be of particular value where any attempt to get at the truth may be clouded by emotion and political bias.

Reasons for Being Dissatisfied with the Present System of Industry.

Since approximately 10 per cent of the people own 40 per cent of the wealth in most countries, since we possess the physical capacity for producing all the goods and services which we want, and, since 90 per cent of the people of any community live on just the barest level of subsistence, certain ideas of change and of reform naturally arise, for history teaches us that systems last only so long as they render efficient service. We shall, therefore, go on to consider six criticisms of the present system of industry and finance; and it is proposed to consider them in a spirit of critical exposition rather than in the spirit of the propagandist and the cynic.

The first school of criticism that we shall consider is one that we can call the capitalistic school. It admits the disparity of wealth distribution, but it claims that this is the result of inexorable economic laws which must be allowed to work out to their logical conclusion. Its representatives are of the opinion that the remedy for the present unfortunate state of affairs lies in increasing efficiency, both personal and national; it can be found by softening the hardness of the economic conditions by the use of bonuses, forms of profit sharing, co-partnership, and co-operation.

Another school of criticism is that which gives its adherence to the ideas of Henry George, an American journalist who was much in the public eye during the closing years of the nineteenth century. Henry George thought that what was wrong with the present system was that the secretion of the value of the community's

purchasing power in the unearned increment of land values led to a restriction of the purchasing power of the people; coupled with this secretion of purchasing power in land values was a dislike of tariffs which, so Henry George thought, tended to foster monopoly.

By far the best known body of ideas, critical of the existing system of economic and financial civilization, comes from what is known as the Socialist movement. Historically, this movement began with Plato, the Greek philosopher and teacher and the master of Aristotle, but for all practical purposes as a working creed which threatened the present system, it began in the first quarter of the nineteenth century and is associated in England with the name of Robert Owen. The leaders of this body of ideas claim that the present system of industry and finance is defective because the ownership of the means of production, exchange, and distribution is in private hands. This private ownership of the means of production, it is claimed, gives a small section of the people control over the economic destinies of the community. Moreover, the nature of the present system is such that only by obeying the behests of its owners—the master class—can individuals become well-to-do. Thus, for economic reasons, it is difficult to get a change of heart in people in their attitude to the capitalistic system, and it is, therefore, wiser to change the system first.

Another line of criticism, akin to that of the Socialists, though not exactly the same, is that developed by J. A. Hobson, the English economist. In his judgment, the inequitable distribution of wealth is due to the fact that the co-operative factors in the general process of

production manage to produce a surplus. The distribution of this surplus is effected by means of economic "pulls," the surplus going to that economic group which is in the strongest strategic economic position. Moreover, when an economic group gains control of this surplus, it does not maintain an even distribution between the process of investment and the payment of wages. The surplus is almost wholly invested, with the result that a mal-distribution comes about for two reasons: first, there is a tendency to reduce the volume of purchasing power in order to speed up the production of capital goods; second, the process of speeding up the production of capital goods makes it impossible for the reduced volume of purchasing power to purchase the increased volume of consumption goods which flow out of the increased quantity of capital goods. Hobson, therefore, claims that there is chronic under-consumption, and that this is due to over-investment.

The social credit school of critics has arisen since the War; its leader is an engineer named C. H. Douglas. He denies the main contentions of the Socialists, but is inclined to agree with Hobson that under-consumption is the root cause of our economic discontent. But, to his mind, under-consumption arises from a totally different cause from that which Hobson suggests. According to Douglas the defect in our system arises from the effect of the private ownership by the banks of the right to create credit and to recover what has been created from the wages and salaries of the community in the form of additional charges added to prices. This process of creating credit and of recovering it in prices destroys the value

of the purchasing power in the hands of the community. This is a different idea of under-consumption from that advanced by Hobson.

The final criticism of the present system comes from a rather unknown economist in San Francisco, in the United States, named David Atkins. He has the advantage of being a practical business man with fairly widely distributed interests throughout the Pacific. In his view the real cause of all our economic troubles is that we have no accurate economic measure of value beyond gold, which, itself, changes in value as does everything else. This lack of an accurate measure of value enables the wealth of the community to secrete itself in land area, as Henry George suggested, and gives us a taxation system whereby we tax effort and initiative instead of taxing power and domination Atkins, himself, supplies a measure of value which, in his judgment, gives us the accuracy that we require.

It is now proposed to go forward and give a critical exposition of all these six points of view, but before this is done it may be as well to mention the books which give a full account of the above points of view; students can read them if they want to know more about these schools of thought.

Some Books to Read.

The best defendant of the present system of industry and of finance is Hartley Withers in *The Meaning of Capitalism.* Henry George's ideas are best set out in his own book, *Progress and Poverty.* The views of the Socialists can be found in Ramsay MacDonald's book, *The*

Socialist Movement, or better still, in a more modern setting, in Bertrand Russell's *Roads to Freedom.* Hobson's views are shot right through all of his books, but their best presentation may, perhaps, be found in *Work and Wealth.* Douglas has set out his views in *Credit-Power and Democracy,* and David Atkins in *The Measurement of Economic Value.* It is unfair to any of these writers to suppose that the analysis of their contributions that will appear in the next chapter is in any way comprehensive. An attempt is made to do them all justice, but students, if they want to learn more of these views, are advised to go to the books themselves instead of being satisfied with what is said about them here.

The above set of books constitute some very solid study, and those who tackle them must be prepared for something that can hardly be called light reading.

Problem 1. Endeavour to answer the questions set out on page 120.

Problem 2. Defend the point of view of the economists who think that the discussion of problems associated with the mal-distribution of wealth lies outside the sphere of the modern economist.

CHAPTER XIII

THE CRITICS OF CAPITALISM

IN the previous chapter, towards its close, we were concerned with a very brief consideration of the conflicting but critical views of the present economic and financial system. What we shall do now is to examine carefully and fully each point of view in turn. And we shall begin by considering the apologists for the capitalistic school of thought.

The Views of the Capitalistic School.

Those who defend the capitalistic system of economic and financial organization assume, and rightly so, that men are born with unequal ability. If we assume the free play of economic competition among men, the natural effect of this inequality is that wealth and power tend to gravitate into the hands of those best fitted to use economic power. It is claimed that it is psychologically sound to allow people to retain control over as much property and wealth as they can lay hands on legitimately, in order that the community may continue to reap the benefit of the ability that these men possess. Unless this ability is adequately rewarded, it will not function at its highest level. Almost as important as allowing individual ability free play, both in competition and in retaining the reward of effort, are the right to inherit from others and the right to pass on property and wealth to others. If

these rights are safeguarded, able persons feel that their work is worth while because not only can accretions of wealth in the past, arising from the hard work of other able men, be brought forward into the present, but a man, working hard in the present, feels that he can pass on what he has won to the future. This theory assumes that men have original sin in them, and that effort can only be induced by reward or coerced by fear; if working is unpleasant, then not working must be made more unpleasant. Turning to face the criticism that is levelled at capitalism—criticism to the effect that it both degrades the personality of the worker and fails to distribute the goods which it has produced with so much care—the reply to such criticism would be, in regard to the effect of capitalism upon the personality of the workers, that shorter hours, the ever increasing blessing of culture, and other devices for softening the rigour of the industrial system, are safeguarding personality as much as it is possible to do, and that all along the line a paternal Government stands sentinel over the rights of those who work for wages. In regard to the second criticism, the reply would be that mal-distribution of wealth and unemployment, though they are much to be regretted, are the result of the natural ebb and flow of economic circumstances which are, themselves, uncontrollable; all that human ingenuity can do is to mitigate these two evils by such devices as unemployment insurance and the "dole."

Evaluation of the Capitalistic Point of View.

It is difficult to evaluate accurately the capitalistic point of view. There is no doubt that private enterprise

has succeeded in creating a productive machine of considerable efficiency; but its increased capacity for producing goods, though it has considerably improved the welfare of the labouring classes, has not improved their lot at the same rate that it has increased its own productivity; notwithstanding the increased capacity for producing goods and services of which the present industrial machine is capable, there is still a considerable amount of apparent over-production and want. It is this curious paradox of increased potentiality and increasing unemployment that makes people critical of the existing regime.

The Views of Henry George.

To Henry George, economic ills appear to be in the nature of human progress. Though not a Socialist, he admitted the force of most of the criticism of the Socialist school, though he was, himself, too much of a believer in the power of individualism to accept their creed. It was the size of the unimproved land value that swallowed up the resources of the people, and this unimproved land value should, in his judgment, be taken in taxation; and this was to be the only tax. Were this done, i.e. were unimproved land value taken in the form of a tax, three excellent results would follow: owners of unimproved land, rather than pay the tax, would be compelled to sell their land; in consequence land would become plentiful and cheap, it could become the property of all people, and the possession of land by the people would lead to increased production and employment.

Criticism and Evaluation of Henry George.

The best critic of Henry George is Rae, in his book called *Contemporary Socialism.* The first point of criticism to be advanced against the views of Henry George is that land is not the only form of monopoly, and that there are other forms of unimproved values. Further, much of the land value that is regarded as being swollen with unimproved accretion if measured by the index number will not be found to be so extraordinarily high. The influence of credit upon mal-distribution is probably as important as that of the unimproved value of land. Finally, George mistook land for land area. What he meant was land area and not land as it is understood in economics.

On the whole, then, though his ideas attracted considerable attention in his generation, and though his ideas are still preached with all the fervour of a religious creed in many parts of the world, his criticism was superficial and was levelled at a special form of economic evil—rising land values—which was a special characteristic of new countries. In case justice has not been done to his ideas, students are advised to read his book, *Progress and Poverty,* and judge George for themselves.

The Socialist Criticism of the Present System.

We pass on now to consider the Socialist criticism. We can begin with a general consideration of Socialism, but it will be necessary to go on and discuss the three schools of Socialism and not be content merely with general considerations.

Representative Socialist opinion would, doubtless,

admit that capitalism has many good points, but, notwithstanding these, it has now outlived its usefulness. The main weaknesses in the system now are the private ownership of the means of production, together with the right of bequest; the stress laid on individualism and economic selfishness which is opposed to the spirit of association and of co-operation; finally, there is the ugliness and inhumanity of the capitalistic system. These are the general lines of criticism that any representative Socialist would put forward. But before we can have any adequate conception of what Socialism is, we have to examine, individually, the views of the various schools of thought; of these there are three main ones. First, there is the school of the "right" with a programme of nationalization; second, there is the school of the "centre," or the guild socialists and syndicalists, who believe in the reconstruction of society along various applications of the medieval guild idea; finally, there is the school of the "left," or the communists, who believe that the present system cannot be modified, and whose aim is economic communism through the medium of the dictatorship of the proletariat.

Conservative Socialism or Nationalization.

According to the views of the first group, the State should own and administer the means of production. Every one should be compelled to work, and remuneration should be, approximately, the same for every one. If a man does not work, neither shall he eat. The function of the State is to care for the economic welfare of the people. Those who believe in the nationalization of production

point to the fact that in most countries railways, telephones, gas and water, and trams are all removed from the control of private enterprise without any serious signs of economic collapse; and that Germany and Australia have both conducted experiments in State enterprise without ruining the country. If this can be done in one country it can be done in others. Those who believe in nationalization wish to see the State take control of all the services of the State.

Criticism of Nationalization and Its Evaluation.

The general criticism of nationalization is that it is inefficient, and that it leads to some form of bureaucracy; and further that it is based on some form of economic force. In respect of these three criticisms, it may be said at the outset that the spirit of the times, in all schools of thought, is against nationalization; there was so much State control during the European War that people came to resent it, and, finally, they came to be tired of it. Hence, the argument that nationalization would develop bureaucracy is a real one—psychologically. Nevertheless, it is only fair to point out that nationalized industries are not the only inefficient ones; if inefficiency is to be a reason for opposing anything, then it should also be a reason for opposing private enterprise, which is inefficient in many respects.

Moderate Socialism, Guild Socialism, and Syndicalism.

The reaction from nationalization was syndicalism—particularly in France, where it is a very popular doctrine,

especially with working men. Syndicalism means that an industry is controlled and managed by those who work in the industry; this control and management applies to everything in the industry, including wages and conditions. The good thing to be said about syndicalism is that it represents, in its form of organization, the general trend of industry at the present time. In almost every country in the world, producers tend to organize themselves so as to improve their industry, and so as to obtain such an amount of information about themselves that they may be able to speak with some authority about their industry. So the syndicalists, in asking for producer-control of an industry, are merely recognizing the trend of the times. The most important argument in support of syndicalism is that it gives producers possession and control of their own destinies in the economic sense.

Criticism of Syndicalism.

There are several things to be said in criticism of syndicalism. In instances where we have had producer-control, there has invariably been a tendency to ignore the wishes and the interests of the consumers, especially in respect of prices. Syndicalism is also open to the charge that any form of technocracy is open to. Technocracy means government by experts or technicians. Such men invariably take a narrow technical view of any proposal, and are liable to attacks of professional jealousy and to quarrels among themselves. They do not, in consequence, take a broad, general, and dispassionate view of either a situation or a policy. Since syndicalism

would place the expert and the technician in charge of everything, it may be expected that syndicalism will suffer from the above-mentioned defects. Finally, as has already been pointed out in this book, those who control policy in modern industry are those who control finance. The supporters of syndicalism imagine that the policy of a business can be controlled by the experts of a business, meeting as a committee. This can never be, because whatever advice experts may have to tender has to be considered by those who supply the finance of the business—whoever they may be.

Socialization of Industry.

Still part and parcel of the middle or moderate standpoint is the compromise between nationalization and syndicalism which goes by the name of guild socialism or socialization of industry. This brand of Socialism may be regarded as England's special contribution to the problem of Socialism. By guild socialism is meant the ownership of the means of production by the State and their administration by those who work in the industry. To bring about such a method of organization industries are to group and organize themselves as they did in medieval times, or as they do in modern Italy under Fascism. Each industry will have a national committee to control it, every province will also have its controlling committee, and every firm or business likewise. On every committee, at every stage, whether national, provincial, or local, there will be representatives both of consumers and of those who work in the task of distribution. These men will be there so that the committees shall not ignore

the wishes of the consumers. The industries of each state shall be organized into national guilds, and each guild will send representatives to the national economic Parliament or Guild Congress. This Parliament will be concerned, solely, with economic affairs, and shall not be allowed to over-ride the ordinary political Parliament, which shall still continue to function—handling matters of a non-economic character such as education, foreign policy, and law. Any deadlock arising with the economic Parliament could be settled either by a joint session between the bodies or by leaving the final control with Parliament—the political Parliament. The main function of the Guild Congress or economic Parliament is to map out the programme of economic production, to plan, that is to say, and then to hand over to each guild or industry its share of the work. Each guild will then apportion its share to the provincial guild, which will ration out its share to each firm in the provincial area.

Criticism of the Socialization of Industry.

This form of Socialism, when it first came into public notice, was extremely popular; it avoided the faults of nationalization, and it did not involve producer-domination, as did syndicalism. It also aimed at production for use and not for profit, and it endeavoured to bring back into modern industry both the ideas and the ideals of the medieval guilds. Although it attracted the attention of very many able men who were not associated with the Socialist movement, it, somehow or other, never appealed to the practical minds of the trade union rank and file, and it never gained a footing inside the unions. It also

suffered from the fatal defect of imagining that the policy of an industry can be determined by calling together the representatives of an industry, and by having a discussion round a table and then taking a vote on a proposal. Policy, in modern industry, is determined by those who put up the money to finance a programme of production—generally a bank or a group of bankers.

The Contribution of Socialization.

The guild socialist movement has, however, done much to clarify the general body of ideas on the prevailing economic situation, and it has come to make people realize where control in an industry does really rest. It has also shown people that even with nationalization, syndicalism, or guild socialism there would still be inflation or deflation; hence there would be rises and falls in prices, and unemployment, booms, and slumps. To have discovered this before committing any country to any of these forms of Socialism was a noteworthy contribution, while the service rendered in crystallizing opinion was quite definite.

Communism.

Within the Socialist movement, there is a small body of men who have always been suspicious of nationalization, syndicalism, and guild socialism. These men are the communists, who, taking their stand upon the teaching of Karl Marx, and on that of those who have developed Marx's teaching, want something quite different from those who favour the conservative and more moderate forms of Socialism. These communists are so convinced

of the rottenness of capitalism that they are sure it contains within itself the germs of its own destruction. Their idea is to wait until the capitalist system breaks down as the result of internal incompetence. Then power will fall into the hands of the able few, who, steeped in the principles of communism, will set up the dictatorship of the proletariat. The duties of this dictatorship, when once it had been set up, would be the maintenance of order, the organization of the means of production, exchange and distribution, and the education of the masses in the principles of communism. Then, when the selfishness in human nature had been educated out of people, and when those born under communism had reached man's estate without having been brought up under the evil influence of capitalism, the dictatorship could be abolished because men could live in a condition of reasonable co-operation. Work would be required from every one according to his capacity, and food, shelter, and clothing would be given to every one according to his needs.

Criticism of Communism.

This extreme form of Socialism has been given a great fillip by the misery resulting from the War and by the visible paradox of well-filled shops and starving unemployed; while the increasing success of the economic system that has been built up in Russia, which neither military attack, naval blockade, nor economic boycott has yet overthrown, has encouraged the growth of the communist movement in all countries throughout the world.

Communism is a much older remedy for the ills of society than most people imagine. The Greeks were very familiar with it, and it would be to our advantage, perhaps, were we to call to our aid what one of the outstanding Greek economists and philosophers had to say about communism in his day. Aristotle groups his criticism of communism under five heads. With regard to the desire of the communist for the destruction of private property, Aristotle would reply that common property is no one's property. Next, to the wish of the communist that all should associate on terms of equality with one another, he points out that compulsory association with others always engenders friction. Thirdly, he suggests that if all were to share in the goods of society, there would be no need for generosity, and were there no need for it it would die. Aristotle would prefer us to share voluntarily what we have, rather than hold it compulsorily with others. Finally, he points out that if communism is to succeed, it must operate in small areas or countries in order to preserve the spirit of patriotism that would be necessary to make it work. On the whole, these criticisms of Aristotle are sound and can be applied to-day just as well as in his day. He did not say, though he might have said, that communism is based on force, and hence for that very reason is to be condemned.

General Evaluation of the Socialist Position.

This brings us to the end of our consideration of the Socialist position, and of its criticism of capitalism. We have taken the three main schools of Socialism, and have considered their criticism of capitalism and their remedies

for it. Before going on to consider the other criticisms that were mentioned in the last chapter, there are one or two general remarks that can be made. There is very little doubt that the Socialist criticism of capitalism is a very telling one, and that many thoughtful and good men, in all ranks of society and in all walks of life, agree with much of it. But here they stop because the suggested remedies do not appeal to them, on the ground that the creed is too destructive. Somehow or other, the thinkers of the Socialist movement have built up no constructive technique for retaining the benefits of capitalism—and capitalism has undoubtedly brought the world some benefits—while remedying its defects. At the same time, it must be admitted that Socialism has become the religion of about one-third of the human race. But it still seems to suffer from two fatal defects. In the first place, its followers and thinkers imagine that it is possible to have a redistribution of existing income, and that by doing so every one will be much better off. Such an action would be psychologically unsound, and can be shown to be statistically an impossibility. In the second place, it overlooks the fact that in modern industry control rests with the forces of finance and not with the forces of production. No Socialist thinker whose works the writer has read has ever tackled the problem of the control of credit, and of its influence upon the price level, upon the distribution of wealth and upon the level of potentiality. On the contrary, Socialist thinkers and legislators have proved themselves most orthodox in all matters connected with finance—in practice, that is, though they are critical of capitalistic finance in theory. Until they give

up the first of these matters and seriously face the credit problem, then there is no health in them—except as destructive critics who have made a great contribution in this respect. They have helped us to see where the defects in the capitalistic system may be found: they have not yet shown us how to remedy them.

The Under-consumption School of Critics.

We now come to a group of thinkers who, though they existed before the War, did not come so much into prominence as they have done since then. While they do not rank themselves with the Socialists, and, in fact, two of them are definitely critical of the Socialists, they are profoundly dissatisfied with the existing state of affairs in industry and finance. Two, at least, of these men whose views we are going to consider belong to that group of thinkers who incline to the view that the capitalistic system fails to function because, in the working of the productive processes, insufficient effective demand is distributed to absorb the total retail production at the price necessary to repay the cost of production.

The Views of J. A. Hobson.

The first of these men we have already considered rather hurriedly. In his view every producer must receive a minimum of subsistence in order to be able to contribute his share to the productive process. If this is not forthcoming, then the contribution of the element in production that is denied its share will be lacking. If, for example, an insufficient rate is paid for interest, then those with money to lend will not lend it. If those who

possess land are dissatisfied with the amount of the rent offering, then they will withhold land from use in the process of production. If wages and salaries are insufficient to keep body and soul together, then wage-earners and salary-earners will not offer their services. Hence, each factor of production must be offered sufficient to make it worth while for it to take part in the productive process. Then, Hobson goes on, since there is an unearned increment in association, the working of the productive forces together in the processes of production does tend to produce a surplus—does, in fact, produce a surplus. This surplus, or rather its existence, creates a struggle for the possession of it, and, normally, it goes into the possession of that factor of production which is in the strongest strategic position economically. This is what Hobson calls distribution by "pulls." The influence of this surplus upon under-consumption arises, not so much from the fact that the surplus is distributed by economic "pulls," but from the fact that when the factor most strategically placed gets hold of the surplus, it is invested in plant and machinery instead of being spent in wages and salaries. This leads to over-investment and to over-capitalization, and reduces the consumer's purchasing power.

The Views of C. H. Douglas.

The other critic of this under-consumption school, who is not a Socialist, does not think that this shortage of purchasing power in the hands of the consumer is due to over-investment and to over-capitalization. On the contrary, Douglas thinks that the unrestricted issue of credit

by the banks leads to inflation, because the goods in respect of which the credit has been created cannot possibly appear on the market for some time. This is the first instance in which the existing purchasing power of the community is reduced. But this is not all. Later, this credit is withdrawn by the banking system and cancelled, but it leaves behind its mark in that its original issue appears as a cost of production, and is included in price. This additional cost has to be gathered in from the consumer, and since it does not exist as purchasing power, another round of credit has to be created in respect of some new form of production in order to make it possible to repay the bank its original loan. This process goes on in a snowball fashion. As a simple illustration, Douglas asks us to imagine a house built for a thousand pounds out of a bank advance; when the house is built it is sold for a thousand pounds and the bank is repaid. That is to say, the quantity of purchasing power in the community has not been increased, but a thousand pounds in value in the price system exists. This thousand can then be reloaned and a thousand pound machine can be built and sold, and the bank repaid. There is thus a second set of values of one thousand pounds existing in the community, while there has been no increase in the volume of purchasing power. If total purchasing power is equated to the prices of the goods, then because of the additional two thousand pounds for the house and the machine there must be a shortage of purchasing power for the other existing goods. Douglas states this principle in a general way by saying that the factors in cost are made up of two elements, viz. wages, salaries, and dividends, which he

refers to as A payments, and other payments, whatever they may be, which he refers to as B payments. He contends that B payments never reach the consumer, since they are payments made by a firm to other institutions in the form of overhead costs, for example, interest to some bank, lighting to some electrical company, insurance to insurance companies, rent to some landlord, and so forth. But the price of a commodity, according to current notions of costing, includes both forms of payments, i.e. A plus B payments. Hence goods priced A plus B have to be bought by a volume of purchasing power that is made up of A payments alone. This cannot be done, and hence the productive system lags, creating unemployment, unless the banks go on swelling the snowball of credit, and they are not always prepared to do this. Hence to Douglas the key to the weakness in the present system lies in a flaw in the price system.

Douglas has no quarrel with capitalism on the technical side. In his judgment it is most efficient, or rather it is as efficient as it is allowed to be within the limits of a system whose methods of pricing are faulty. He has no quarrel with capitalism generally, but he does think that there is a fundamental flaw in the financial department of the capitalist system which allows the bankers to pump costless credit into the monetary system, thereby causing inflation, and were it not for improved methods in process and in technique, which offset the inflation, the situation would be worse, much worse, than it was at the end of the War. This costless issue of credit which causes inflation is then recovered in prices, in respect of the goods that are created by it. It is this flaw that Douglas is concerned

to set right. In his judgment the credit factor should be kept out of the cost of production, so that the cost of a unit of goods would be just that amount of effort, whether of man or of machine, which is required to produce it. He proposes to do this by measuring effort taken to produce something by the amount of consumption, considered in the broadest sense, that is involved in its production. Hence the cost of production of an article is the financial ratio of what is consumed in producing it to the present financial cost of production including profit. Considered nationally, the cost of production is the ratio that consumption bears to production. The difference between consumption and production, whether considered for an individual article or for the national programme of production, is the credit factor introduced by the banks and created by them. It is this element that Douglas thinks should not be allowed to appear in prices. He then goes on to develop his constructive scheme for eliminating the credit factor, but this need not concern us here.

Evaluation of the Douglas Theory.

The British Labour Party examined Douglas's proposals soon after the War and pronounced them to be unsound, though Douglas refused to appear before it to give evidence or to answer questions, on the ground that its members were incompetent to deal with such matters as business and finance because they were unversed in practical affairs. Later, Douglas was invited to give evidence before the Standing Committee on Banking of the Canadian Parliament. His views were not accepted

by that Committee, but his visit to Canada aroused considerable interest, particularly among farmers. He also appeared before the Macmillan Committee in 1930 and gave evidence.

Douglas's views do not appear to have been accepted by orthodox academic economists; on the contrary, the writer has seen no considered discussion of his views by any competent economist anywhere, though several offhand references have appeared in one or two minor books. The bankers generally have pronounced neither in favour of nor against him, though there have been one or two minor references to his work, of a critical character, in banking journals. It is probably a fair statement of his position to say that his proposals have not yet been analysed by any competent academic economist, banker, or prominent business man for a considered judgment to be passed upon them. The Douglas theory is very difficult to understand, though it is attracting a considerable number of followers, notably amongst the farmers of Canada, and among members of the professional classes in England, Australia, and elsewhere.

The Views of David Atkins.

The final critic of the present system whom we shall consider in this chapter is David Atkins, of San Francisco, in the United States. His work is almost completely unknown. He was placed amongst the first twenty in the competitors for the Bok Peace Prize in America after the War, and his essay, entitled, "The Law of Flow," was published with the other nineteen in a book called *Ways to Peace*. He has also published two books, *The*

Economics of Freedom and *The Measurement of Economic Value*. The best way of explaining to readers the exact position occupied by Atkins in the history of economic thought is to say that he endeavours to complete the work of both Henry George and Irving Fisher, the American mathematical economist. Readers must turn to Atkins's published work if they wish for a comprehensive presentation of his views, but the following represents a brief statement of them.

He is convinced, as most of us are, that we need an unimpairable measure of value, so that a pound sterling will always be a pound sterling, or a dollar a dollar, instead of varying from year to year as the result of inflation and deflation, or from scarcity or over-abundance of supply. Atkins examines carefully Irving Fisher's attempt to give us a stable measure of value in his compensated dollar, but he rejects Fisher's attempt, and proceeds to give us one of his own. He postulates that the measure of value shall be itself made up of factors which can themselves be measured. He takes three elements to make up his measure, which he calls a man-acre-year; these elements are population, land area, and time.

By multiplying these three elements together, in the judgment of Atkins, the total value of any given community is obtained. The wealth that each person possesses should represent a fractional measure of the total wealth. The value in a community can be increased by an increase in either of the elements, population or land area, but not in time, since this cannot be increased, though it can be intensified, which is a different thing. For example, the

discovery of gold in a certain area would attract new population to that area and, in consequence, would enhance its value. The extent to which the general value would be increased would be determined by the effect of the increase in population as a multiplier in the three elements. General values would, of course, fall in those areas from which population had come. The relation of Atkins's thought to that of Henry George consists in the fact that he believes that surplus value tends to conceal itself in land values, which gives the possessor economic power over his fellows, enabling him, thereby, to dominate their lives.

The way in which Atkins would "switch over" from capitalism to freedom is as follows. He would ascertain the total man-acre-years in a given community by his formula, and that would give him his general value for the year. Then he would take the total capitalistic value as set out in official records, and would square these to his total of man-acre-years. Then he would decree that every man should retain his present wealth at its fraction of the capitalistic value, and he would obtain the result in man-acre-years. Then he would abolish all taxes save those on land—this is Henry George's single tax—and he would allow any one to retain that quantity of land which he would find it profitable to employ. Inflation and deflation would be combated by the unimpairable measure of value, presumably, and those who worked would have their gains safeguarded for them instead of having them impaired by inflation, as at present. Directly a man put his money into land, he would come within range of the instrument of taxation,

and he could retain that quantity which he could profitably employ. The State would be prepared to employ any one, but private employers would have to offer a higher rate of inducement than the State if they wished to attract labour, and, if for any reason employers could not pay the higher rate, then the labourer would withdraw his services and offer them to the State.

Apart from these comparatively few simple devices for altering the present system of valuation from gold to the man-acre-year, and the few necessary complementary alterations, Atkins does not propose any other changes. He is rather anxious to avoid antagonizing any one, and that is why his scheme makes so few alterations in the existing state of affairs.

Evaluation of the Views of David Atkins.

His ideas are so novel and are presented in such unusual language that it is difficult, at first, to grasp what is meant. Atkins appears to be following the reasoning of Fourier, Ohm, and Carnot, as applied to heat and electricity, and he uses the idea that a flow of anything (water through a pipe, wealth from a community) can be measured in terms of its limits, i.e. by its density, cross-section, and time. In the economic realm the cross-section is land area, the density is population, and time is a constant factor in either case. Whether or not it is a legitimate device to try to apply a law in heat or electricity to the realm of economics, is left to those who are both physicists and economists to judge. But we can agree that what we do want at the present time is an unimpairable measurement of value.

A General Estimate of the Criticisms of Capitalism.

Having had capitalism under criticism for two whole chapters, we must pause now and endeavour to make some estimate of all the criticisms. We may make one point before we go any farther, and that is that, regardless of what economic system is ultimately set up, economic laws will work themselves out.

The system under which we live appears to take its motive force from the wishes of those to whom the bulk of wealth is distributed, and in this it may be said that the distribution of wealth is an important condition of its operation. Whatever the system, there will always be the hand of man, aided by the instruments that he has created, working upon environment in time in order to produce the means of subsistence. Where we begin our criticism of the *status quo* is at the point where we come to determine what we are going to do with our means of subsistence once it is produced. Here we may venture to make a few remarks. It does appear that productive capacity, as things are at present, has outrun, not the needs of man, but the purchasing power of the consumers at the present level of prices. It is obvious that the purchasing power in the hands of people varies. Whether this is unavoidable, whether it is due to over-investment, whether it is due to an unsatisfactory price system which does what it should not, viz. includes the effect of a costless credit issue on prices as an element in cost, or whether it is due to an impairable measure of value, it is difficult to say, and much more difficult to get support for one's views; but it is a fit matter for skilled inquiry,

such, for example, as the Macmillan Committee has been engaged in. Credit and population appear to be related, and prices and banking policy are closely related. It *is* a matter for considerable surprise that our present industrial technique does not leave us better off than we are. We are face to face with the curious paradox of a very large volume of unemployment and a huge stock of both capital and consumption goods; while ruin seems to stare every one in the face.

CHAPTER XIV

INTEREST, PROFIT, AND RENT

QUITE early in this book we talked about the factors of production. We took these to be land, labour, and time. The idea then was that by linking land and labour in time we got production. Economists are, however, very fond of looking at this idea of the factors of production from a different point of view, viz. from the point of view of those to whom the product is shared out. When looked at in this way it is customary to speak of the factors of production as land, labour, and capital. Land receives rent, and this is the remuneration of the fortunate possessor of it. Wages are the reward of labour, and interest is the reward of the person who is the happy possessor of capital. In this chapter we shall discuss interest and profit and rent, but only in a simple way. Readers who wish to go more deeply into these matters should read Gide's *Principles of Political Economy*—those portions concerned with interest, profit, and rent, upon which this chapter is based.

Interest Historically Considered.

We shall begin with a historical consideration of interest. As we know, the Church condemned usury, with certain exceptions, but these exceptions were so comprehensive that the interest charges had to be very high before exception was taken to them; even then it

was merely a religious objection that was taken to them. This would not worry a medieval money-lender very much. Thomas Aquinas, the great medieval Catholic scholar, who saw clearly the growing power of finance and of commerce, so reconstructed the Church's attitude to interest and capital that a conflict between the Church and the growing power of finance was avoided. When the Protestants broke away from the Church, Calvin for them did the same thing that Aquinas had done for the Church.

The first body of economists to justify the payment of interest were the Physiocrats; these were a group of French economists who lived before the days of Adam Smith. They approved of the payment of interest in the extractive industries, i.e. in agriculture and in mining.

Adam Smith appeared to assume the legitimacy of the payment of interest, and he built up no theory of interest in *The Wealth of Nations.* Then came John Stuart Mill, who said that the rate of interest depended on the supply of capital and the demand for it, and this may be regarded as being the general attitude of the classical school of economists to interest. Mill also suggested that interest was the reward of abstinence—an idea which Senior stressed. Senior also introduced the idea of time into consideration of the whole theory of interest. Then the famous Austrian economist, Böhm Bawerk, suggested that it was the prospective under-valuation of the future that determined the rate of interest. Irving Fisher, the American mathematical economist, developed this idea. According to Fisher, we prefer present satisfaction to future satisfaction; hence, if we offer to pay people goods in the future, that is, if we offer them future

satisfaction, we must offer these goods or this satisfaction at a premium. This is what is meant by the prospective under-valuation of the future. David Atkins, the unknown economist from San Francisco, has a completely different view of the nature of interest from that of any other economist. He regards the whole activity of man in his struggle with Nature as an attempt by man to build up sovereignty over Nature. The sovereignty that has been won or accumulated is stored up as capital, and may be regarded as a form of "potted" financial sovereignty which may be bought or hired by those who want to use it. Interest, to Atkins, is the amount of money that we pay for the use of sovereignty in a unit of time. £3 per cent represents the command which valid money has over sovereignty in a unit of time.

Gide, of the Collège de France, to whose book on the principles of economics reference was made earlier in this chapter, points out that there are three theories of interest, viz. the productivity theory, the view that interest is the price paid for the use of capital, and, thirdly, the theory that interest is the price of time.

The Productivity Theory of Interest.

The first view is that the use of capital enables the user of it to produce additional wealth, and that out of this fund of increased wealth, interest is a payment to be made for the use of one of the factors of production. In criticism of this view Gide suggests that the extra production which arises from the use of capital, and as a result of which interest is paid, results in a fall in the price of the commodity because of the increase in the supply. He

adds that all that capital can expect is that it shall be repaid by means of a sinking fund to replace the wear and tear that arises as a result of the use of capital; i.e. if I borrow a man's plane and use it for any purpose, the interest that is paid to him is a payment for the depreciation caused to the plane by the user of it.

Interest as a Rent for Capital.

The second theory is that interest is the rent of capital. This is what might be called the practical or business man's point of view. I borrow £1,000, and I pay a rent for its use just as I do when I borrow the use of a man's house, or a man's field, but I can enjoy the usufruct which comes to me as a result of the use of this capital just as I can that of the house and garden, or of a field. In criticism of this view Gide suggests two things; first, that capital is destroyed as it is consumed and, since the capital has to be paid back, why pay interest in addition for what is consumed? Secondly, capital is transformed into something else by the user—it does not always remain capital; it either becomes consumption goods or capital goods in another form. If this is the case, then interest may be legitimately regarded as a lease.

Interest Regarded as the Price of Time.

The third view is that interest is the price of time. This is the view taken by Böhm Bawerk and by Irving Fisher. Gide suggests that though this may be so, it is not always so. For example, a bag of seed wheat is worth more at sowing time than at present, that is to say it is more valuable in the future than in the present—a direct

contradiction to the argument that goods in the present are more valuable than in the future. Gide adds that there is interest, properly so-called, that is, interest which is an insurance. He also points out the tendency for the rate of interest to be higher in new countries than in old ones. The reason for this is twofold, viz. there is a greater demand for capital in new countries than in old, and the high demand for capital forces up the rate of interest for it. There is also the element of risk. The element of the risk of the loss of capital is greater in a new country than in an old because of the uncertainties of many kinds.

Ricardo and many of the French economists inclined to the view that the rate of interest would fall because of the continuous process of saving, but the facts do not appear to support them. It is important to notice the effect of inflation and deflation upon the rate of interest. Six per cent at the conclusion of the War, when the value of the pound, franc, or dollar was low, may not have been any higher than three per cent before the War. It is a question of the relative command over goods which £3 had in 1914, when compared with the command over goods of £6 in 1920, or in 1931, that matters.

A Consideration of Profit.

We pass now to a consideration of profit. The general formula for profit, according to Gide, is as follows: $P = V - (W \text{ plus } R \text{ plus } O)$, where V means the price received for goods, W means wages, R means rent, and O means other costs. In other words, profit means the difference between the price of an article and the cost of production. Marx, the foremost economist of the Socialist

school of thought, points out that profit is extra or surplus value which the capitalist or employer filches away from the worker. Hobson points out that all the elements or factors of production must, if they are to continue to make a contribution to the process of production, be paid their upkeep, i.e. interest to capital, rent to land, and wages to labour. If there is a surplus, it goes to that element which is in the strongest strategic position and can command the strongest "pull" in the economic struggle. Hence the difference between price and minimum costs sometimes goes to the landlord as an extra rent, sometimes to the labourer as extra wages, and sometimes to the employer. When it goes to the employer, it is called profit. This view is not unlike that set out in Gide's formula, except that it brings in the element of risk.

A Consideration of Rent.

We have, it will be remembered, already touched on rent in an earlier part of this book when discussing the factors of production. There are two theories of rent, the static and the dynamic, according to Gide. They are really the same theory, but the dynamic theory fits in better with the facts. According to the static theory, differential fertilities of soil produce different results when dosed with the same amount of capital. It is this differential return upon the same amount of capital invested that produces rent. That land which only just repays the trouble spent on it is said to be on the margin of cultivation and it pays no rent. If, however, the price of what is produced from the soil falls, then

the farm on the margin of cultivation will not pay its cost of production, and it goes out of production. If, however, the price of the commodity produced by the land rises, it will be possible to bring into cultivation land or farms which, till that moment, have remained outside the margin of cultivation.

The dynamic theory of rent differs from the above only in that it is made to fit what actually happens in any country in regard to the development and cultivation of the land. When people go to a new country, they generally settle on the most fertile land first. Then, as population increases and as more immigration comes into the country, the pressure on the land increases, and the less fertile land is then taken up. In this way the static theory of rent, as stated above, assumes a form to which the name "dynamic" is given by the French economist Gide.

Problem 1. Apply the three theories of interest to the fall in the rate of interest that has come about since 1929, and say which of them explains best the fall in the rate.

Problem 2. An American economist says that in a new country people take up the worst land first and not the best, and that rent is explained by the gradual movement of the population from the less fertile to the more fertile land. Critically examine this view.

CHAPTER XV

PUBLIC FINANCE AND TAXATION

WE now come to that part of economics which goes by the name of Public Finance or Taxation. Every State, at one time or another, incurs expenses on behalf of its citizens, and these expenses can only be met by taking money from the people and using this money for the purpose of meeting the expenditure that has arisen. Of recent years, as a result of the wars in which most nations have indulged, the public debt of all countries has become considerable, while at the same time the ordinary day-to-day governmental expenses, other than those incurred for war, have gone on. So there are, as it were, two kinds of public expenditure, the ordinary day-to-day variety, and the special kind that arises in connection with some particular debt—such as a war debt. The citizens of new countries often imagine that they will be better off than in old countries in that they think they can live simply, do without public expenditure, and avoid the most expensive of all modern State activities, viz. war. In practice this is not what has happened. All new countries find that they have to borrow to put up public buildings, and to establish railway and postal communications and similar public necessities. Then the land of the new country has to be surveyed, there is police protection to be established and maintained, and the forces of Nature have to be brought under control.

To accomplish all this, a young country has to borrow, and directly it borrows, interest charges have to be met, and this can only be done by taking away from the people some of the wealth that they have.

In practice, too, it has been found that no new country is able for long to keep itself free from a war debt. Australia, South Africa, the United States, and Argentina —all the new States have developed war debts, while the older countries of Europe have never been without them.

Illustrations of the Effect of War Debts on Taxation.

As an illustration of how a war will cause a country's taxation to increase enormously we may look at some of the following figures. In 1914, at the opening of the War, Britain's National Debt was £687,000,000; in 1920, it was £7,859,000,000. In Australia in 1911, the Commonwealth Public Debt was £5,932,322; in 1918, it was £284,055,169. In every country of the world to-day, probably 6d. in every shilling that is paid in taxation is paid on account of past wars or for getting ready for the next war.

Theories of the State and Their Relation to Taxation.

Before we can proceed farther with our consideration of taxation, it will be desirable to venture a little into the realm of political science in order to have clearly before us some conception of what the State really is, because the attitude that we adopt to the State largely determines the attitude that we adopt towards taxation.

In considering the relation of the State to taxation, there are three theories that may claim our close attention.

These three theories are: first, that the State is an association that we all join; second, that it is one of the many forms of association; and, third, that the State is the only means by which an individual can find himself to be of any account, i.e. it is through the State that the individual finds a means of self-expression. This third theory is the German conception of the State.

The State as an Association that We All Join.

If the State is an association that we all join, then it is only reasonable to expect that all who join this association do so for some just cause and that, in consequence, they can be expected to contribute to its upkeep. If this were true, the argument would be a very sound one. But it is not true.

All of us are born into the State, and not voluntarily join it, and we have to obey its behests in varying degrees; if we resist these behests, the State has power to deprive us of our liberty.

Directly we begin to earn an income, the State, through the taxation department, descends upon us, and we have to pay not only for the current activity of the State, but a portion of its past activity before we were born. This being so, it cannot be claimed that the State is an institution that we all voluntarily join. It is rather an institution into which we are all born, and out of which we do not appear to be able to contract, and every one must belong to some State or other.

The State as One of the Many Institutions We Join.

This brings us to the second idea of the State—that it is one of the many institutions that we join. We most of us belong to a trade union, to a golf club, or to some type of club or society, and the State is just another such of these forms of association. There does not appear to be much force in this contention. There are plenty of people who do not join societies, plenty who were never in a trade union or a club; moreover, were they in such an institution, they could leave it, if they wanted to. But most of us would find it difficult to find an individual who was not a member of some State or other. A person may change his State, though it is a difficult thing to do, and it involves many formalities, but a person may not leave a State and belong to none. It is inaccurate to say that the State is an association that we all join, but it is also inaccurate to say that the State is one of the many forms of association. What then is the nature of the State?

The German Theory.

The German view of the State is that it is impossible to conceive of the individual as existing without the State, or some form of the State existing without the individual. The State is the institution through which the individual functions. Because of this fact the service of the State is the individual's highest duty, and the claims of the State outweigh all personal considerations. The individual is, as it were, a fractional unit of the larger institution which is the State. This is a very simple conception of the State and, as an idea or a theory, it has a much wider acceptance than most people imagine.

Nevertheless, as a conception, it has certain objections. It is very much open to doubt whether the claims of the State should outweigh those of a personal character. Such a conception not only interferes with our idea of personal liberty, but it interferes with the right of private judgment, and may interfere with personal rights of a religious character. Moreover, it is very doubtful whether the State is the sole instrument through which the individual finds a means of self-expression. There is the Church, the family, there is one's work. Nevertheless, of the three views of the State that we have been considering, the German view goes as near to describing the facts as it appears to be possible to go. It is true that we are all born into some State, that in many respects we function through it, and it has considerable claims upon us. Curiously enough, though it may take our lives from us, as it did during the War, it is difficult to think of a case where it has asserted the right to take *all* our wealth away from us; it may take some, but not all. Soviet Russia provides a possible exception to this.

The Function of the State in Relation to Taxation.

Now that we have fortified our minds with some consideration of the nature of the State, we may, with advantage, pass on to consider the function of the State in relation to taxation. Adam Smith thought that the function of the State was the provision of certain facilities, such as defence, justice, and public buildings. To use the language of the realm of boxing, Adam Smith thought that the function of the State was to keep the ring, and to

let the contestants fight it out. This may be considered as the classical position in regard to the function of the State in relation to taxation. Jevons, once Professor of Political Economy, University College, London, took what we may call the expediency point of view of the function of the State in relation to taxation. He thought that it was for the State to undertake certain types of expenditure because, by omitting to spend money in certain directions, the State ultimately found itself committed to greater expenditure than it otherwise would have been put to; or if it were not put to expense, it might be put to some form of inconvenience. On this argument—that of expediency—the State has made itself responsible for the poor, for medical inspection of the wage-earners, and, probably, for unemployment insurance.

Finally, there is the Socialist view of the function of the State in relation to taxation. To the Socialist the State is the representative of the strongest economic force in the State, and it is the duty of the State to protect the interests of the class which it is supposed to represent. Associated with this view is the hope that it will be a Socialist Government that will take this view and that, in consequence, it is the wage-earners who will be protected by the State.

A Definition of the Word "Tax."

With these preliminaries out of the way, we may pass on to discuss three definitions of the word tax. The first is that of the American economist, Taussig, that a tax is a compulsory levy with the absence of a direct *quid pro quo*. That is to say, the State levies a direct contribution

from us and we cannot, at the moment, find a direct return for our contribution—though there may be an indirect return. Next, we can consider the definition given by Hugh Dalton, the author of a book on taxation and, at present, a member of the British Cabinet. His definition is that a tax is a compulsory contribution imposed by public authority, irrespective of the amount of service rendered to the taxpayer; and not imposed for any legal offence. This is more comprehensive than the definition of Taussig, and it gets in the idea that a tax is not imposed for any legal offence. The third definition is by Robinson, in her book, *Public Finance*, one of the Cambridge economic handbooks. To her a tax is a compulsory exaction by the State of a part of the wealth of an individual for public purposes. This appears to be the best definition of the three because it includes all the ideas of both Taussig and Dalton, and it is not so verbose as that of Dalton. We shall, therefore, follow this definition, and every time we use the word tax, it should be understood that it is used in the sense of the definition of Robinson.

Proportional or Progressive Taxation.

We may now consider briefly two main types of taxation. Once it is settled that people are to be taxed, the next point to be decided is upon what principle people shall be taxed. Our ideas of justice suggest that taxes should be required from people in accordance with their capacity to pay them. The science of public finance suggests two principles in this respect, and we have what are called proportional taxation and progressive taxation. Proportional

taxation means that a Government takes a percentage, the same percentage, from all the people who are to be taxed. For example, let us assume that there are five people with the following incomes—£10,000, £1,000, £500, £250, £150. If these five incomes are taxed 10 per cent it means that each income will pay, respectively, £1,000, £100, £50, £25, and £15. This is a very simple way of arranging the taxation of a country, but the objection to this system is that £15 means much more to a person with an income of £150 than £1,000 to a person with an income of £10,000, because the former person only has £135, while the wealthier person still has £9,000. Such a method of taxation violates what is known as the principle of equality of sacrifice in taxation. In order to overcome this difficulty, taxation theorists have invented a system known as progressive taxation. By progressive taxation it is hoped to remedy the injustice of proportional taxation. What is done is that more money is taken away from people the higher their incomes are. For example, say, 1 per cent is taken from people with small incomes, 10 per cent from people with medium incomes, and 50 per cent from people with large incomes. But even this does not quite do justice to the people with very small incomes. As a matter of fact, what really happens is that smaller incomes are exempted from taxation altogether; then, in addition, allowances are made to a man if he has a wife, and further allowances if he has children. After these allowances have been made then his taxation begins, and it may, even then, be at half the regular rate. After this the progressive taxation begins. Even where 80 per cent of the very high incomes is taken, it is not

possible to preserve properly the principle of equality of sacrifice. Still, things are very much better than they were.

Lord Passfield and the Principle of Equality of Sacrifice.

The most interesting suggestion for improving the taxation system further in order to bring it in closer conformity to the principle of equality of sacrifice is that of Lord Passfield—better known to the world of economics as Sidney Webb. He suggested that before an income is taxed it should be divided by the number of people that it has to support. For example, a man earning £300 a year who has a family of two will, if his income is divided by three, only have a taxable income of £100, and after the deductions of the normal scale are applied he escapes all taxation. This seems only fair to him. Under the present system, though he would not pay very much, he would probably have to pay something. It is unfortunate that, even with the Labour Party in power, nothing has been done to experiment with this very sensible and just suggestion of Lord Passfield. If adopted it would make all the difference in the world to the present incidence of taxation, and would greatly relieve the middle-class taxpayer, who at present pays more than his share of the burden.

The Canons of Taxation.

Ever since men have begun to reason about the problems of taxation, they have endeavoured to formulate rules or canons by means of which it would be possible

to detect the weaknesses in bad schemes of taxation. The most famous of these canons or sets of rules are those of Adam Smith which first appeared in his book, *The Wealth of Nations*. There are four of them—

(*a*) The subjects of every State ought to contribute towards the support of the Government as nearly as possible in proportion to their respective abilities, that is, in proportion to the revenue which they enjoy respectively under the protection of the State.

(*b*) The tax each individual is bound to pay ought to be certain, not arbitrary. The time of payment, the manner of payment, the quantity paid, ought to be plain and clear to the contributor and to every other person.

(*c*) Every tax ought to be levied at the time or in the manner in which it is most likely to be convenient for the contributor to pay.

(*d*) Every tax ought to be so contrived as both to take out and to keep out of the pockets of the people as little as possible over and above what it brings into the public treasury of the State.

These rules or canons are so long that it seems best to suggest single words by which to refer to them instead of using the above sentences, According to Adam Smith, first of all a tax should be proportional, then it should be clear, then convenient, and finally economical.

We know to-day that Adam Smith's first canon of taxation is wrong, and can no longer be defended. The other three, however, are still sound canons, so that we may, with advantage, consider each of them a little more fully.

The Canon of Clearness.

Let us discuss the second canon. This canon requires that taxation should be assessed according to a principle

so clear that any one can work out its application to his income. This prevents any attempt at secret manipulation by the taxation officials or any one else.

The time, manner, and quantity of payment are required to be set out so that a person may know what is demanded of him, and so that the tax may be paid in a form convenient to the Government. It would not do if people were to pay in wheat or in cattle.

The Canon of Convenience.

The third canon, convenience, aims at getting taxation levied upon persons at a time that is convenient; it also suggests that a levy should be made once a year or, at least, at definite periods of time. For example, a bad time at which to tax farmers is after their crops have been sown, and a good time to tax them is when the harvest has just been disposed of. This canon also suggests the idea of giving people a little notice of their tax, say, a month or two months.

The Canon of Economy.

The fourth canon has to do with economy in the collection of the tax. This means that the tax should be cheap to collect, so that practically all the money which is taken from the taxpayer finds its way into the Treasury instead of being wasted in various ways between the taxpayer's pocket and the Treasury. Lloyd George's land tax just before the War violated this canon, because it cost more to collect the tax than the tax itself returned to the Treasury. This was because of the opposition of

the landlords, who resisted the payment of the land tax by every means known to the law.

Problem 1. Is it reasonable for any generation to commit future generations to the payment of taxation on debts?

Problem 2. What do people mean when they talk about the necessity for *sound* taxation?

CHAPTER XVI

CLASSIFICATION AND FORMS OF TAXATION

We are now going to consider the question of the classification of taxation by reviewing the methods of classification that are suggested by the best-known taxation authorities that there are. The views of five men have been selected for discussion. These men are Plehn, Nicholson, Bastable, Adams, and Gide. We shall consider the classification of taxation according to the way in which the taxes are spent after they have been collected; that is to say, from the point of view of expenditure.

The Classification Adopted By Plehn.

Plehn says that taxation ought to be levied upon people according to the amount of benefit that they receive from the expenditure of the State, or from the services which the State renders to them. According to this principle, Plehn classifies all expenditure out of taxation under four headings, viz.—

(*a*) Expenditure that benefits the individual.

(*b*) Expenditure which confers a special benefit on some, and a common benefit on all.

(*c*) Expenditure conferring a benefit on all.

(*d*) Expenditure that confers a special benefit on special classes.

The Classification Adopted by Nicholson.

Nicholson makes his classification from a point of view that is quite different from that of Plehn. He adopts the

principle that taxes should be classified according to the amount of money that the tax produces in return for the expenditure involved. Acting on this principle, he divides all taxes into the following four classes—

(*a*) Expenditure without a direct return.

(*b*) Expenditure without a direct return but with an indirect one.

(*c*) Expenditure with a partial direct return.

(*d*) Expenditure with a full return or a profit.

We may now, perhaps, comment on each of these classes so as to make Nicholson's meaning quite clear.

An example of the first kind of expenditure is the money spent on the Army, Navy, and Air Force, i.e. on defence. This gives a direct return to no one. Money spent on education is an example of the second type of expenditure. There is no direct return, but there is an indirect return because public education makes the citizens of a State more intelligent and, hence, more law-abiding. It is less expensive to govern an intelligent community than an ignorant one, and this is a saving in the cost of government, and, hence, expenditure on education gives an indirect return. An illustration of expenditure that gives a partial direct return is that which arises from expenditure on public services that do not pay, i.e. the services of the Foreign Office, the work of which could not be dispensed with. Finally, as an illustration of the fourth class of expenditure—that with a full return—it is difficult to think of one in the British Empire taxation systems, but the tobacco monopoly in France and in Italy would be an example taken from one of the taxation systems abroad.

The Principle Adopted by Bastable.

Bastable, the Irish authority on public finance at Trinity College, Dublin, does not bother with an intricate classification. He has only one heading, viz. that the taxation of a community should be based upon the needs of the State.

The Classification Adopted by Adams.

Adams' classification is based on the following principle, that the protective element in State expenditure declines and the developmental element increases with progress. It would be interesting to analyse the expenditure of the leading world powers to see to what extent Adams' principle works out, bearing in mind that, probably, to-day all modern States are devoting sixpence out of every shilling of taxation to the task of paying for past wars, or getting ready for the next. However, the principle was true of Australia before the War, though it is not true now.

Adams' classification falls into three headings, viz.—

(*a*) Expenditure for protection.
(*b*) Expenditure for commercial purposes.
(*c*) Expenditure for developmental purposes.

By protection Adams means defence of all kinds. By commercial purposes he means taxes which go to make up the provision of facilities, so that the task of earning one's living may be made easier. By developmental purposes he means expenditure for increasing the productive capacity of the community by building railways, and by making provision for irrigation and similar public works.

The Classification Adopted by Gide.

Finally, we come to the classification adopted by Gide, the French economist at the Collège de France. He adopts a threefold scheme, viz.—

(*a*) Taxes on acts.

(*b*) Taxes on commodities.

(*c*) Taxes on persons.

Getting married, or buying a house, and similar activities, and the fees or charges involved in doing these things, would come under the first of these headings. The whole range of protective duties would come under the second, and the income tax under the third.

It is important to realize that these classifications of expenditure are not of very much value from the practical point of view; their interest is mainly theoretical, and as such the classifications are very interesting.

The Income Tax.

No discussion of taxation would be regarded as being adequate unless reference were made to the income tax. We may, therefore, go forward and consider it rather carefully. There are two things about the income tax to be considered before we can give it a detailed examination. These things are ability to pay the tax and economy in its collection.

In discussing ability to pay, there are five things to be kept in mind, viz.—

(*a*) What is the best time unit for the collection of income tax?

(*b*) What is income?

(*c*) How is income measured?

(*d*) How is income derived?

(*e*) How is income spent?

When we know something about all of these five points, we are in a position to attempt to determine the principle of ability to pay. Let us, therefore, enlarge upon all of these points. The most suitable unit of time for the collection of income tax would be that in which the majority of the people receive their remuneration—either wages, salaries, or other forms of income. Wage-earners are paid weekly, salary-earners monthly, or occasionally quarterly, and dividend-earners half-yearly or yearly. By far the greatest number of people are paid weekly, but to tax people weekly would entail an enormous amount of work, and it would not be a feasible proposition at all. Moreover, most wage-earners, in most countries, are not required to pay income tax and, hence, there is no special reason for fixing on the week as a convenient period for calculating income, and there are several reasons why it should not be selected. Most countries have selected the year as being the most convenient time in which to measure income—presumably because those whose incomes are above those of the wage-earning class are paid so much per annum.

What Constitutes Income?

It is not by any means an easy thing to determine exactly what constitutes income. People so often have different aids of a non-monetary character which are, in themselves, in the nature of income, while others for various reasons do not get the full use of their incomes. Here is a man with an annual income of £250, but he lives

rent-free. How shall we treat the rent-free part of his income? Here is another man with a salary of £300 a year and he is compelled to live in a certain house, but he gets the use of the house for fifteen shillings a week, whereas its real rental is thirty shillings. How are we to measure this man's income? Here is another man who lives on his business premises; he pays rent for this property, but it comes out of the expenses of his business, and he lives upstairs in three of the rooms. How are we to treat this case? Here is another man with an income of £350, out of which he allows an aged relative £100 a year. He has no wife or family, but the actual money which he has for himself is £250. Yet his official income is £350. Then there are other anomalies such as the free schooling that is generally allowed to the children of clergymen, or rights that are allowed such as the right to gather firewood, or vegetables, free of charge.

The usual method in the levying of income tax is to exclude from payment of the tax all those below a certain level of income, it being assumed that incomes at this level cannot sustain the weight even of a small tax. Next, in order to preserve the principle of ability to pay, those whose salaries are slightly higher than those who are exempted are taxed at a very low rate, which increases fractionally as the income rises, or else the normal rate is halved or quartered. In addition to this, in order to give consideration to a man's domestic responsibilities, allowances are usually made for a wife and for children. Sometimes it is the custom to make allowances for relatives wholly maintained by him, while deductions are often allowed for money spent on insurance premiums, and

sometimes for money spent on a doctor. Generally, it is not possible to cope with the various forms of invisible income that we discussed above, but, in some cases, taxpayers are required to add a percentage to the income if they live rent-free. This fact is ascertained by asking people to state on their return form what rent they pay, and to whom they pay it.

This discussion covers items (*b*) and (*c*) above, so we can next go on to consider whether, in assessing an income for taxation, any regard should be had to the source from which the income is derived. Normally, in most modern countries, it is held to be more virtuous to obtain an income by working for it with hand or brain than to obtain it from property or from an investment. In this connection some taxation departments classify incomes as "earned" and "unearned"; a heavier rate is then levied on the "unearned" income than on the "earned."

How an Income is Spent.

Finally, we have to consider whether, in assessing income for taxation, we should make an allowance for the manner in which a person spends his money. This raises for consideration the very large and formidable question whether or not the State should interfere in the private life of its citizens. There is, of course, something to be said for the view that a man who spends his income wisely on food, education, and housing is to be preferred to him who spends it on racing, gambling, and intoxicating liquor. Here the case is clear. But what is to be done when comparing, for example, money spent on

education and money invested in railways? On the whole, the State has omitted to take into consideration the manner in which a man spends his income, when determining his ability to pay. Nevertheless, there are a few instances where the State gives a preference to certain forms of expenditure, when it exempts from taxation money devoted to war loans, to insurance, and sometimes to sickness.

The Principle of Economy in Collection of Income Tax.

We pass next to a consideration of economy in taxation. Here there are three considerations, viz. (*a*) that the tax should be designed to check the flow of taxation into the Treasury as little as possible, (*b*) that in taking income, the least useful part of an income should be taken first, i.e. that part of an income above the amount required to buy the immediate necessities of life, and (*c*) that as far as possible, the sole loss to the taxpayer should go into the Treasury. These three guiding considerations explain themselves so that we need not waste any time in attempting to explore them further.

We shall spend the remaining part of this chapter in mentioning and briefly discussing some of the main forms of taxation, other than the income tax, and then we shall make a few remarks about what is known as the "incidence" of taxation.

Let us begin with the property or land tax. This is the tax that is favoured by Henry George and by David Atkins. What is done in the case of this tax is to ascertain what portion of the value of each piece of land

that people possess is due to unearned increment, as distinct from increased value that has come as a result of improvements made by the owner. When this difficult point has been decided the whole of the unearned increment is confiscated. One of the first countries of the world to adopt this form of land tax as a result of the teaching of Henry George was South Australia. Henry George personally visited the State and had his reward in seeing it adopt his favourite tax. The tax has never been exacted in full, and, as a matter of fact, it is never possible to ascertain what is the unearned increment. What is done is that the State simply takes one penny in the pound, or some such amount, on all land values.

The Inheritance Tax.

Another form of tax that was known before the War but which was not very much used was the inheritance tax, or the "back tax" as it is known in America. This is a tax that is levied upon a person's estate before it is handed on to his heirs. Since the War this tax has been made a very heavy one, particularly in England. Objection is taken to the tax on quite unreasonable grounds. It has to be remembered that, were it not for the existence of the State, there would be no such thing as inheritance, for it is the State which sees to it that the wishes of the dead men are carried out. This being so, it would not appear to be unreasonable for the State to change the conditions upon which it transfers wealth from the past to the present. If a wealthy man wishes to avoid the payment of the inheritance tax, all he has to do is to transfer his wealth to his heirs before death or prior to the

time before death which the law requires. This is precisely what the wealthy man or woman does not like doing.

Some Miscellaneous Taxes.

Another tax that appeared with the War was the Excess Profits Tax. All kinds of extravagant things were said of this tax when it was first introduced, but none of the fears expressed in connection with it have materialized. During and after the War it produced a considerable revenue for those governments which had the good sense to use it. Most countries abolished the tax after the War.

The remainder of the miscellaneous taxes are the stamp duties tax, the gambling tax, the amusement tax, the luxury tax, and the turnover tax. The stamp duties tax is the duties which have to be paid in order to give full legality to certain transactions; the names of the other taxes describe them, so no more need be said about them. None of them is ever very satisfactory from the point of view of producing revenue, and they mostly belong to that group of "punitive" taxes which governments, in a necessitous condition, like to impose occasionally. They are all more suited to the days of Puritan morality than to a modern system of scientific taxation.

The Incidence of Taxation.

So far, save in one instance, we have avoided the use of the word "incidence." But no discussion upon taxation is adequate without it, so we must make some reference to it. When a Government imposes a tax, there is no

certain knowledge who, in the long run, is going to pay it. This uncertainty arises because of the fact that many people are able to pay the tax imposed upon them and then to shift it on to someone else, and, often, that person is able to pass it on to another, and so on. As we saw when we were discussing protective duties, directly an importing merchant pays a protective duty on a commodity, he proceeds to pass it on to someone else. If he is successful, then the technical description of his act in the science of taxation is that he has "shifted the incidence of the tax" from himself to others. When we ask what is the incidence of a tax, we want to know who, in the long run, pays the tax. The incidence of some taxes is easy to shift, of others it is hard; and it is most important to consider, when imposing a tax, what will be the incidence of the tax.

Hobson and the Incidence of Taxation.

One of the most interesting and useful theories connected with the incidence of taxation is that of J. A. Hobson, the English economist, to whom reference has been made on more than one occasion in this book. As we have seen, Hobson claims that all the elements in the productive process, that is, land, labour and capital, must get their cost of upkeep given to them in the form of payments, otherwise they will refuse to function. Any payment, over and above this elementary cost of upkeep, he refers to as surplus. Hobson's taxation theory is that only those factors of production which earn a surplus can possibly bear taxation; and if for any reason a tax is placed where there is no surplus, it will be bound, in

the nature of things, to be shifted elsewhere—to where there is a surplus. It is a very simple theory of taxation, and there is in it much that is commendable. Those who are interested in it are advised to read more about it in Hobson's book, *Taxation in the New State*.

Problem 1. Discuss any objections that you may think of to Lord Passfield's method of taxing in order to obtain equality of sacrifice.

Problem 2. Critically examine Hobson's theory that all taxation tends to settle on the surplus.

CHAPTER XVII

BUDGETS

WITH the necessary preliminaries of the previous chapter out of the way, we can go on to consider the Budget, that is, the national financial statement which is prepared for most States each year by the Treasurer, and in which is set out the financial position of the State. The word "Budget" was, originally, a French one, viz. "bougette"; this was the bag in which the French Minister of Finance carried with him the papers which he required for making his financial statement. The word "Budget" has to-day actually two meanings: first, it means the statement in which is set out the valuation of the nation's receipts and expenditure; secondly, it means the legislative Act establishing and authorizing certain kinds and amounts of expenditure and taxation.

The Budget Before it Reaches the Legislature.

As this book is written for English-speaking students, we shall only discuss the Budget and its associated problems as applied to the governmental institutions in countries where English is spoken. The practice in connection with the Budget before it reaches the legislature differs in different countries, but we can examine the procedure in England and America. In England the Chancellor of the Exchequer requires each of the Government departments to furnish an estimate of what it is thought its expenses for the year will be. The officials

of the Treasury examine these various departmental estimates or statements, and then they are returned to the various departments for reconsideration and alteration. They are next returned to the Treasury for a final scrutiny, they take official shape, are presented to Parliament, and are there defended by the Chancellor of the Exchequer. After the Chancellor has made his Budget Speech, the House of Commons, acting as a committee, examines and debates the Budget line by line.

In the United States the procedure was, until recently, somewhat different. The Treasurer prepared the estimates and sent them to Congress in the form of a report with the fullest possible details. Congress then took this report and handed it over to committees such as the Committee on Appropriations, the Committee on Ways and Means, the Committee on Harbours, Rivers, etc. It was the function of these committees to turn the Treasurer's report into a Budget. This was the American procedure until 1921, when it was altered. In that year, under the Budget and Accounting Act, the duty of shaping the Treasurer's report into the official Budget was taken away from these committees and handed over to the Treasurer and the rest of the Executive or Cabinet.

Neither Parliament nor the public in any country is satisfied with the way in which the Budget is managed or presented; yet no one seems able to bring about an improvement upon the present method.

The Weaknesses in Presenting the Budget.

There are two defects in the British system of handling the Budget. In the first place a technical document,

very difficult to understand even for trained economists and accountants, is placed before a body of laymen who, in a very short period, are supposed to master it sufficiently to be able to criticize it intelligently. Secondly, under the existing arrangement, the English Chancellor of the Exchequer is placed in the position of a financial dictator because, though he may listen to much criticism of his Budget, he rarely allows any alteration in it; he has the majority of the House behind him, and if any member really attempted to alter the Budget, he would find himself outvoted. Hence, there is rarely any real, constructive criticism of the British Budget. The man who counts in the British Budget is the permanent official responsible for it at the Treasury.

In America the position is entirely different because the Treasurer has no control over his estimates. Once the report, together with the details, is out of his hands the responsibility is elsewhere. Until 1921 there was really no co-ordination in making up the American Budget, but this was altered by the Act of that year. The President of the United States has, under the American system, very little opportunity of influencing the Budget in its earlier stages, though this defect was partly remedied by the Act of 1921.

Should a Treasurer Budget for a Surplus or a Deficit?

To the representative citizen such a question may seem a curious one. To most of us the idea of deliberately planning a Budget for a deficit seems dishonest. Yet, in the nature of the case, it is not possible to make the

estimates in the Budget so accurate that, at the end of the year, there is neither a surplus nor a deficit. Now what is the Treasurer to do, knowing the facts? If he deliberately budgets for a surplus, he is taking more money away from the taxpayers than he actually needs, and the Civil Service, knowing this, will not be as careful as it might be, realizing that there is a little spare money available in the form of a surplus. On the other hand, if the Treasurer deliberately budgets for a deficit, the very fact of the existence of a deficit will make the Civil Service more careful of expenditure in the Departments; while, at the same time, to budget for a deficit means that there is no over-taxing of the citizens of the community. Even if the Treasurer budgets for a surplus, there is no certainty that he will get it; there is always the possibility that some unforeseen economic event will occur to turn the surplus into a deficit.

Methods of Meeting a Deficit.

Assuming, therefore, that he is going to budget for a deficit, there are three ways in which the loss may be met. First, there is the presentation of a supplementary Budget. Second, the loss may be met by the issue of deficiency bills. Third, there is the method of the orderly mid-year deficits. The first of these methods is like the presentation of a second Budget, proposed as soon as the Treasurer realizes what the size of his deficit will be. To meet the loss in the form of deficiency bills requires the amendment of the law which approved the original Budget. To make good the loss according to the third method there are three things that

can be done. First, the Treasurer can get extended grants for approved services. Second, he can indulge in a series of financial juggles and transfer surpluses from those departments or funds which have balances to those which show a deficit. The third method for meeting the mid-year orderly deficit is for the Treasurer to keep a fund in reserve—up his sleeve as it were—to which he can go in case of need. For this purpose some Treasurers maintain an overdraft at the bank. In England, the Chancellor of the Exchequer has three such funds upon which he can call in case of urgent need. These funds are called the Treasury Chest Fund, The Civil Contingency Fund, and the Secret Service Fund.

The Function of the Auditor-General.

One of the problems of modern public finance is to see to it that funds are spent in accordance with the law of the land, i.e. that the money voted by the legislative authority has been used for the purpose for which it was intended. In most countries a special officer is appointed to see that public moneys have been spent in accordance with the law of the land. He is sometimes called the Auditor-General or the Comptroller. He is, normally, an officer independent of the Government, and situated much in the position of a judge; that is to say, he is under no obligation to allow the wishes of the Government of the day to interfere with or to influence, in any way, his opinions or decisions. This officer is supposed to go through the accounts of the Government, and to say whether the accounts are in order and whether the money has been spent in accordance with the intention

of the law of the land. The reports of most Auditor-Generals (or Comptrollers) make very interesting reading. Unfortunately, very few members of Parliament ever read these reports, and fewer still of the members of the public. Nor does Parliament often think fit to act upon the suggestions of the Auditor-General—most of which are most useful. It is a great weakness in the system of public finance in most countries that the Auditor-General is not allowed to prosecute departments and, in some cases, to compel a Government to take serious notice of his report.

In France the work of the Auditor-General is done by the *Cour des Comptes*; that is, by a court of accounts. This is a judicial body, and it can prosecute departments in cases where it discovers irregularities in any of the accounts.

The Importance of the Treasurer.

The Chancellor of the Exchequer or the Treasurer is one of the most important members of any modern Cabinet, and in many cases he has more influence than the Prime Minister. This is because, holding the purse strings, he is in a position to determine policy; and no Cabinet can act without its Treasurer where the spending of money is involved. Another important point to be remembered about the Treasurer is that he has to maintain the very closest touch with the financiers and the financial institutions of the country concerned—particularly with the banks—and specially with the central banking institution. It is usual for a Government, in selecting a Treasurer, to select one who is *persona grata*

with the banking community, because of the constant and intimate connection between the Government and the financial community. In a sense, this is one of the great dangers of all modern democratic governments. We have already seen how the policy of production is determined, in the last resort, by those who control finance; we have seen how the volume of credit—and hence in large part the price level—is determined by the banks. It would not be in the interests of free government that the banks or any section of the community should be in a position to influence the selection of so important a man as the Treasurer of a Government, because of the key position that he occupies in the Cabinet. Yet the story of many of the financial disasters in some of the new countries, as also in some of the old ones, is that of a dishonest and anti-public liaison between some Treasurer and one or more of the leading banks. Students who are interested in this aspect of public finance should read Count Corti's two books, *The Rise of the House of Rothschild* and *The Reign of the House of Rothschild*.

Problem 1. Think out a scheme whereby the House of Commons might keep a greater control than it does over the British Budget.

Problem 2. Indicate any way in which the criticisms of the Auditor-General could receive more practical attention than they do at present.

CHAPTER XVIII

THE PLACE OF ECONOMICS IN THE SOCIAL SCIENCES

We have now completed, as far as has been possible in the space at our disposal, our study of the subject-matter which goes into economics. What we want to try to do in this chapter is to determine, as exactly as we can, what place economics occupies in the social sciences. Before we do this, however, it is desirable that we should have before us some clear picture of the inter-relation of the activities of the mind as they take shape in the various branches of human study.

Psychology and Economists.

In order to be able to do this we must know something about the operations of mental processes and of their action and re-action upon the material world around us. This takes us into the realm of psychology—a field of study with which all good economists should be familiar. Unfortunately, there are very few economists who are psychologists, and there is a large field, lying between economics and psychology, that needs to be tidied up by economists who are also psychologists. Till this is done economics will remain for some time to come a very muddled science.

How Human Effort and Human Motives are Developed.

Human energy, of which human motive is a part, comes into operation when an object in the outside

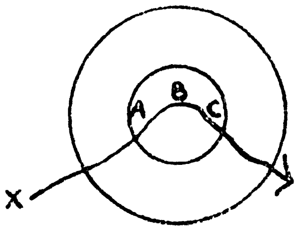
world is able to thrust itself upon the human mind with sufficient force to enable the individual to become aware of the existence of the object. Another way of stating the same thing would be for us to say that a stimulus, external to the mind, impinges itself upon human consciousness and sets up human activity. The stimulus might also be within the mind. The point at which the stimulus thrusts itself upon the notice of consciousness is known as the "threshold of consciousness," and the activity that is set up in the mind is called a *sensation*. That is to say, a stimulus causes a sensation in the mind when it becomes aware of the stimulus. This word *sensation* is not used here in the popular sense, as when we say a certain event "causes a sensation." In the psychological sense in which the word has been used it is a technical term, and is used to describe the particular form of response that a stimulus calls up in the mind of an individual.

When a sensation is set up in the mind of an individual, something—exactly what it is difficult to say—makes the mind of the person adopt an attitude to the sensation. The person likes, dislikes, or is neutral towards the feeling that is stirred up by the sensation. Once this attitude of mind has been expressed towards the feeling set up by the sensation, then there follows some further mental action. If the person likes the sensation, he normally wants more of it, and appropriate steps are taken to secure this. If the mind of the person dislikes the sensation, then some attempt is made to be rid of it or to avoid it, or to avoid its repetition. Should the mind of the person be neutral or indifferent to the sensation,

then some mental action, appropriate to the existing situation, will take place.

A Picture of the Above Explanation.

We can represent what we have been saying about the response of the mind to a stimulus by the following diagram—



The outer circle represents the physical part of the body through which the sensation must pass before it reaches the "threshold" of the mind. The inner circle represents that portion of the mind where decisions are taken. The part marked *A* is where the mind becomes aware of the impingement of the stimulus upon it; the portion marked *B* is where the mind takes the decision to like or dislike or remain neutral to the stimulus; while the part marked *C* represents that portion of the mind where some mental activity leading to physical action is set up. *X* represents the stimulus. Psychologists have suggested names for these parts of the mind. The "awareness" part of the mind is generally called Cognition; the like or dislike part goes by the name of Affection—though this must not be mixed up with the ordinary word "affection" used to describe the emotion of a woman for a man, or of a

mother for her children. The third part of the mind is referred to by psychologists as Conation.

(*N.B.* These "parts" of the mind must be clearly understood to be not actual areas or spaces: *they cannot be localized.* They are merely convenient divisions of mental activity.)

Another Way of Representing the Divisions of the Mind.

There are aspects of human activity that can be attached to these portions of the mind, and, though it is both impossible and undesirable to distinguish these portions of the mind from one another, we can speak of branches of knowledge that have their foundation in one or other of these divisions of the mind. There are the cognitive sciences like mathematics and logic. There are the arts, such as music, which more naturally come into the "Affection" portion of the mind. There are the other mental disciplines, such as ethics and religion, which can be placed under the heading "Conation." We can now re-construct our diagram of the circles and represent it in this way—

MIND { *Cognition*—Logic, mathematics, etc.
Affection —Music, painting, art.
Conation —Ethics, morality, religion.

An Error Against which to Guard.

At this stage it is important to point out that the illustrations that we have used so far are only diagrams or pictures; they do nothing more than make things clearer and, in this way, help the mind of the reader to

form for himself some conception of the branches of knowledge and of their relation to each other. The table should also help the reader to come to an understanding about the relation to each other of the various books in this "Art and Life" series. So far, however, there has been represented only a certain aspect of psychology, known as facultative psychology; and this branch of psychology does not by any means represent all aspects of psychology or even all points of view—and, in particular, it does not include what is known as dynamic psychology. But, if we keep these points in mind, and if we try to recall what we have learned about economics in the various chapters of this book, we should be able, more or less, to say what place among the various branches of knowledge economics does occupy.

What is the Driving Force in Human Activity?

But before we attempt this we ought to push our analysis of human motives more in the direction of the springs of action, because, unless we really get to understand the psychological basis of human motive, we deprive ourselves of one of the most satisfactory forms of approach to the study of economics. And it is particularly important in a series of books dealing with "Art and Life" that we should get to understand the psychological basis of economics as of every other science or art.

An Example of the Driving Force in Human Activity.

Let us assume that we are sitting in a room or in some enclosed space. Let us also assume that a savage lion

walks into our midst. Most of us would immediately seek refuge in flight by jumping out of any windows that there might be, or by escaping through another door, if there was one. Let us now analyse this instance and endeavour to find out why it was that we acted in the precipitate way that we did.

First, the lion is a stimulus which immediately impinged itself upon the threshold of our consciousness. Next, the attitude of the affection part of our mind to the stimulus was one of extreme hostility; then came the operation of a certain amount of conative force, leading to action, and we all fled before the presence of the lion. Now the question is: what caused us to fly? The lion—that is to say, something in our external environment? Or was it the knowledge in our minds of what the lion might do? That is to say, was the driving force inside our own minds and not in the external environment? Let us examine both of these possibilities more closely. We shall begin with the assumption that it was the stimulus in the external world. Would we have fled from a puppy or a cat or a horse? No, we should not. Hence we may assume that it was a particular form of stimulus in the external world that caused us to fly, i.e. it needed a lion or some animal with certain attributes of fierceness to make us move. Would a child just capable of walking, and who had not yet learned to read, or who had not been told stories about lions—would this child have fled from the lion? It is unlikely that it would, and it is more likely that it would attempt to approach the lion for the purpose of stroking or patting it—possibly assuming that it was a large cat or dog. Assuming this

to be the case, then we have to ask ourselves why grown-ups fly from, and a small untutored child approaches, the *same* object in the external world.

Why do Adults Fly from the Lion?

The answer clearly is that both we and the child act because of something in our mind. *We* act because of our knowledge that a fierce lion can destroy human life. The *child* acts because of his knowledge of cats and dogs to which the lion bears some resemblance. We to protect our lives flee from the lion; the child to enrich the experience of his life moves towards the animal. That is to say, we both move from motives connected with the maintenance of our individuality or from a desire to maintain or to enrich our personal sovereignty. Fear moved the grown-up individual: love of pleasure, associated with similar animals, moved the child. Hence, we may say in this case, as in others, that the driving force of human action was the presence of a stimulus about which the human mind knew something; this resulted in human action, the nature of which was the attainment of personal sovereignty. Hence, we may, perhaps, say that the driving force in human action is self-protection and self-satisfaction, that is, emotions closely related to the human personality and reacting on the external environment.

The Importance of this Piece of Analysis.

This piece of analysis and its conclusion are important because there is a school of thought which maintains that the whole of human activity is a mechanical

reaction to the external world, that it is matter which determines mind, and that the whole of our present civilization is simply the result of the mechanical environment passing through our minds and re-appearing on the other side, as it were. Now, we have seen from our analysis that, though the stimulus of the external environment is necessary to provoke the mind to activity, it is the mind, or what has come down from the past into the mind, that makes it respond to the stimulus. The nature of this process, that brings down from the past experiences, attitudes of mind or predispositions, is connected with the study of the mind in relation to the unconscious or the subconscious, and we need not enter into it here—most interesting though such a study is. Directly, for any reason, a human being's mind refuses to function, or when he loses command over his mental faculties, no stimulus in the world will move him to flight or to anything else.

The Application of the Theory of Self-Protection to Economics.

We may now apply the results of our analysis to the subject that we have been studying. The stimulus of hunger, resulting in fear that one may die or that one's wife and child may die, drives the individual to bring his faculties into play in order either to outwit the forces of his environment or to satisfy the demands of his internal nature. In this way economic activity does not differ materially from other activity, except that its springs of action are more deeply rooted and more fundamental than those of other activity. As an activity, it is liable

to cease directly the desire for food, clothing, and shelter is satisfied. It is at this point that other psychological forces come into operation which serve still to stimulate the economic activity of the individual. He wishes to enhance his reputation in various ways, so he attaches property to his personality; or perhaps the love of power is strongly developed in him, so he makes wealth; and command over wealth gives him command over the lives of others. Or he may wish to project his personality or his ideas into his wife or his children, and he does this by endowing them with a similar social and economic position to his own. This he does through the medium of his wealth.

Is Economics an Art or a Science?

It should be clear from the above chain of reasoning that economics is very closely related to, and, in fact, flows out of, the most fundamental of, human activities, viz. self-protection, issuing in the emotions of fear of others or of objects, and of love of self, of others and of objects. The question now is whether economics is an art or a science. That is to say, is it concerned with things as they *are* or with things as they *should* be? Upon this point economists are divided. The subject is concerned—and very closely concerned—with the activities of individuals and with their motives, but the point is whether the subject is concerned with what people actually do want, and the actions resulting therefrom, or whether it is concerned with what people ought to want and with what, in consequence, they ought to do. Some economists get out of the difficulty by saying that economics is two

subjects in one. There is the science of economics, concerned with the organized body of economic facts as they *are*. Economics, conceived in this way, does not concern itself with such problems as the distribution of wealth; it is not concerned to ascertain why wealth is so unevenly distributed, and whether this mal-distribution is right or wrong. It is, in consequence, not concerned with questions of reform, with putting matters right, with Socialism, or other proposals for changing the existing system. It is merely concerned with recording the existing state of things, and with the task of indicating the tendency of things.

Economics as an Art.

Others think that economics is concerned with the task not only of stating the situation as it is, but of suggesting how matters may be improved. Hence the special field of economics lies in suggesting reforms. Looking at economics in this way, the economist is like the engineer. He examines the machine and can tell how it works; but he can also tell how the machine may be altered so that it could be made to work better. In this role the economist becomes the adviser of the statesman, just as the Economic Advisory Council is acting as adviser to the present British Government (1931). If economists are to be judged by their writings, then the bulk of them seem to think that economics is merely a science, the study of things as they are. If they are to be judged by their acts, then economics would appear to be an art; because almost all of the more important economists at one time or another have

either served on Royal Commissions or have given evidence before them; and the purpose of both the Commissions and the evidence of the economist has always been to ascertain the condition of facts as they are and to make suggestions for improving them. Therefore, like most men, economists show themselves to be better than their words. In their writings they attempt to be scientists, whereas in their acts they try to be artists.

Problem 1. Critically examine the contention that self-protection is the driving force in life; and estimate the reaction of your criticism upon the nature of economics.

Problem 2. Discuss the view that economics is both a light-giving and a fruit-bearing subject.

CHAPTER XIX

MAKERS OF MODERN ECONOMICS

It is often considered to be one of the misfortunes of modern study that one never gets time to become acquainted with the personality and the work of more than one economist. We often lose sight of the fact that, interesting though economic ideas may be, what is far more interesting is the character and the personality of the men who are making those ideas. It is important, also, to realize that England is not the only country in which there are schools of economics, and that English is not the only language in which economics is being written and in which economic discussion is being carried on.

What I propose to do in this chapter is to write about some of the leading economists who are teaching and working throughout the world to-day. I know of no book that has done this, and it appears to me that a few words about the leading economists to-day would be a suitable way of rounding off this volume. Since the series, of which this book is one, is called "Art and Life," we must remember that it is men who make both art and life, and this is my justification for turning from the science of economics to the men of economics.

It is my intention to exclude any serious mention of the American economists. I shall confine my attention to the economists of the British Isles, France, Germany, and

Italy, and, on the whole, I shall confine my attention to economists whom I have met. This will mean, of course, that I am leaving out of account some of the modern economists, but that cannot be helped.

The Cambridge School.

I suppose that it would be fair to claim that the best-known school of economics to-day is that of Cambridge. The reason for this is threefold. In the first place, it was made and developed by a very powerful personality—Dr. Alfred Marshall—who died as recently as 1924. Secondly, it has a representative body of ideas which may best be described by saying that they are a continuation of the ideas of the classical school. Thirdly, the school has produced a body of economic thinkers, all in the first rank, whose reputation is international. The present head of the school is Professor Pigou, who was a student of Marshall, and who has occupied his chair since about 1908. The other better-known names at Cambridge are: Mr. J. M. Keynes, of King's College, Mr. D. H. Robertson, of Trinity College, and Mr. Shove, of King's College; while among the economic historians are Professor Clapham and Mr. Fay, who till recently was Professor of Economics at Toronto University, Canada. One of the most interesting economists living at Cambridge, though not actually a member of the school, is Mr. Foxwell, of St. John's College. Mr. Foxwell is, probably, the oldest living English economist, and he held, for some years, the Chair of Economics formerly occupied by Walter Stanley Jevons at University College, London. Mr. Foxwell was a great friend of Jevons, and he also knew

Arnold Toynbee, of Oxford, the tutor of Lord Milner. The Cambridge School is famous for two things—the maintenance of the classical tradition, and its interest in money and in all manner of things connected with money. This interest in matters connected with money has not, in the past, been a characteristic of the Cambridge School, but it has developed more recently as a result of the work of Mr. Keynes and Mr. Robertson.

The London School of Economics.

We pass next to London. The reputation of the London School of Economics is well established and the School is very widely known. This is largely the result of the capacity for organization of its director, Sir William Beveridge, who is best known to economists for his work on unemployment. But the man whom we think of in connection with economics at London is Professor Edwin Cannan, mainly known for his work on the theories of distribution and production. Professor Cannan no longer teaches at London, though his influence upon the school is most marked. Professor Cannan was succeeded by Professor Allyn Young, an American economist of considerable note, but he died in 1927, and his place has been taken by Professor Lionel Robbins, of Oxford, a young man who has not yet had time to make his mark. The outstanding figure at the London School of Economics at the present is Professor Gregory, Professor of Commerce. The economic historian is Mr. R. H. Tawney, the author of *The Acquisitive Society*. Recently, the London School of Economics has given a very desirable lead to the Schools of Economics throughout the Empire by creating

a Chair of Imperial Economics. This is occupied by Professor Coatman, an Oxford man, who has had considerable experience in India. There does not appear to be any outstanding characteristic of the economists at London. They differ from the Cambridge economists on several points, mainly upon questions of money and upon the nature of the bank deposit.

The Other British Schools.

Oxford has as its Professor of Economics Professor MacGregor, of All Souls College. Professor MacGregor was trained at Cambridge by Marshall. He is a great linguist and is a considerable authority upon the trust movement. With Mr. Keynes he edits the *Economic Journal*, the foremost journal of economic opinion in the British Empire. The economic historian at Oxford is Mr. G. D. H. Cole.

I intend to refer only to three other British economists. First, there is Professor Bastable, of Trinity College, Dublin. He is an old man now, but he has done an enormous amount in the last forty years or so to further the study of economics. It was he who first formulated the modern theory of foreign trade in his *Commerce of Nations*, and for many years he was the only British authority on public finance. Professor Bastable has, in a sense, built up a small school of his own in Dublin, of which Free Trade and Public Finance are the outstanding characteristics. He possesses one distinction, shared, it is believed, by no other leading British economist, viz. he was appointed to his present post as the result of a competitive examination. Trinity College, Dublin, has

given up this method of selecting its Professors, and Professor Bastable was the last Professor so selected. Another striking figure in Irish economics is Professor Finlay, the Irish Jesuit priest, who shares with Foxwell the distinction of being over eighty years of age. Scotland, which has given us so many famous economists, from Adam Smith to Shield Nicholson, has now only one matured and well-known economist, viz. Professor Scott, of Glasgow University, the authority on the joint-stock company. The other Scottish economists are rather young to have done anything yet of outstanding merit.

The French Economists.

France is, at the present moment, rather badly off for economists. There is the famous veteran, Charles Gide, the author of one of the best-known and most widely-read textbooks on economics. He is a man of advanced years, and will be retiring soon. Another economist is Professor Rist, who has been almost wholly occupied since the War with work of a practical character in connection with the Bank of France, to which he has been attached as adviser for some years, and in re-establishing the Rumanian currency. These two economists had in their school the present director of the Bank of International Settlements, Monsieur Quesnay. Finally, there is Professor Aftalion, the French authority on business cycles.

The German School of Economists.

Germany has always been famous as the home of the historical school of economics, and for the work, among others, of that great economist, Schmoller, who gave the

Berlin School its great reputation. But, if you go to Germany now, they will tell you that there is no such thing as a German school of economics, that all German economists are interested in all forms of economic thought but that, unlike Cambridge, they give their adherence to no special form.

The schools of economics in Germany that will be mentioned are Bonn, Berlin, Munich, and Heidelberg.

The School at Bonn.

At Bonn there are three very well-known German economists—Professor Speitoff, Professor Schumpeter, and Professor von Beckerat. The first two are theoretical economists in the German sense of the term, while the last-named is very practically minded, being interested in the problem of applying the principles of economics to industry—particularly to problems associated with the trust movement. Professor Schumpeter is a most interesting personality, and for several reasons. He hailed originally from the University of Graz, in Austria. He was one of the outstanding students of the great Austrian economist, Böhm Bawerk, about whom we spoke in our discussion upon interest earlier in this book. During the turmoil at the end of the War, Professor Schumpeter was appointed Minister of Finance in Austria, and he had a very difficult time trying to resist the forces of disorder, and the attempts of those who wished to throw Austria into the arms of Bolshevism. Finally, he retired dispirited, and was glad to escape from the hurly-burly of political life to the seclusion of an academic chair at Bonn. He is one of the most widely travelled of modern

economists, having visited America and England. In consequence of his travels, he is one of the best-known of the continental economists. As an economist, his thought is largely in the classical tradition, and he is very irritated by empirical economics and the use of the inductive method.

The Berlin Economists.

When you visit the Berlin School, they will take you to one of their rooms and show you a bust of Schmoller, the great German economist. They then hasten to add that the tradition that he built up at Berlin is dying out, and that very little of his teaching survives. When one comes to meet the economists of the Berlin School this appears to be true, for Sombart seems to be the only historical economist left. Sombart is a most interesting personality. He is usually regarded as the *enfant terrible* of the German economists, and he is a considerable thorn in their flesh. His lectures attract students from all over Europe, and those who are fortunate enough to be selected for his seminar get close to him and take part in the famous discussions which are so characteristic a feature of his classes. He is, above all, the great economic historian of capitalism and of the part played in its development by the Jews.

Another important economist at Berlin is the Jewish economist, Bonn. Though he is not the ablest economist in Germany, he is, or was till recently, one of the most influential. He is interested in the practical economic problems of Germany, both her domestic and her international ones, and it is in this connection that he has

established contact with the important men of business and of finance in Berlin. He is behind the scenes in all important matters where economics affects national policy. But the most representative, all-round economist is Professor Schumacher. He has a very mature outlook, and an even judgment, and is inclined to be amused by those economists who imagine that there are new economic ideas always lurking just round the corner. It is interesting to remember that Dr. Schacht, the former governor of the Reichsbank, and Dr. Hülse, the deputy director of the Bank of International Settlements, were both former students of Professor Schumacher.

A professor of a different type is Professor Jastrow. He is an old man now, but those who can induce him to talk of his earlier life find that the roots of his teaching go far back into the past. His main interest lies in administrative economics. It is very hard to explain to British minds exactly what Professor Jastrow means by administrative economics. One has to remember that in Germany economics is part of Law, and by administrative economics Professor Jastrow means the economic functions of the State. We in the British Empire would call it Public Administration. Professor Jastrow is at present busily engaged in trying to bring his department of learning up to date, since it has been left untouched by every German economist since the days of von Stein, the great German administrator. Professor Jastrow has one very interesting thing to say about German administration, and it is that in the days of von Stein Germany had the *art* of administration; now she has lost that, and all she has is the *routine* of administration. The great aim in life of

Professor Jastrow is to recover for Germany the art of administration.

The last economist at Berlin that should be mentioned is a new-comer from Kiel, called Professor Gottl-Ottlilienfeld. He is a highly abstract economic thinker, and his contribution to economics is not yet understood, even by his German colleagues. He is a pleasant man of the rugged type,

The School at Munich.

Munich used to be the chair that was occupied by Brentano. He is so old now that he has given up teaching and lives in an Alpine village. His place has been taken by Professor Weber. Brentano is the German authority on the medieval gilds.

The School at Heidelberg.

The last school of economics in Germany that we shall discuss is "old Heidelberg" on the Neckar, nestling right at the foot of its beautiful castle. It was at Heidelberg that the famous Max Weber lived and taught. He is famous because, apart from his books, in 1909 he made his statement about the necessity for keeping economics as a theoretical science divorced from everyday life. He is now dead, and he must not be confused with the Professor Weber at Munich, or the other Professor Weber at Heidelberg. Heidelberg always has, of course, been the home of German philosophy, and that subject has made its influence felt upon the atmosphere of the school of economics, and in the work of the present

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head of the school, Professor Weber. The other economist at Heidelberg is Professor Lederer. Like Professor Schumpeter at Bonn, Professor Lederer is an Austrian, and a pupil of Böhm Bawerk. He is the head of the Institut für Staatswissenschaft at Heidelberg. He is a professed Socialist, and this fact gives him an enormous influence in modern Germany. He has also travelled, and he was in England early in 1930, lecturing at the London School of Economics. Together with Professor Weber and Professor Schumpeter he edits one of the foremost periodicals in Germany, called the *Archiv*. This journal specially concerns itself with those matters which appear to fall in the "No Man's Land" between economics and politics.

A Summary of the German Schools of Economics.

This completes the survey of the modern economists in Germany. Before passing on to consider the Italian economists, there are a few remarks of a general character about the German economists that should be made. The German economists have always exercised a deep influence upon the national life of Germany. They are looked up to by the people, and their advice is welcomed by the Government, which gives them the rank and status of Ministers of State. No other country appears to treat its economists so honourably. Moreover, there is no country in the world where the economist has such freedom to speak his mind from his chair and to criticize public policy. If any one attempts to attack the German economists, there is a special law which protects them in their right to communicate to their students the

conclusions that they have reached as a result of their research. This right was severely tested during the War, but it was vigorously defended.

It is surprising that the German economists have such an influence in national affairs, because it is their proud boast that they reach their conclusions within the realm of theory, and by the use of deductive methods. This is what they mean by being "scientific," and this was the great issue that Professor Weber of Heidelberg raised in 1909 at Vienna. The outstanding exception to this rule that the German economist is "scientific" is Sombart, who is a historical economist, and who is the main teacher carrying on the tradition of Schmoller.

Though they tell you now that there is no such thing as a German school of economics, any one who visits the schools of Germany cannot help being struck by the difference in atmosphere of the schools at Bonn, Berlin, and Heidelberg. In Bonn, owing to the influence of Speitoff and of Schumpeter, the spirit of classical and of deductive economics flourishes very strongly. At Berlin one is impressed by the broad-based character of the teaching, the applied economics of Bonn, the historical economics of Sombart, the abstract economics of Gottl-Ottlilienfeld, the administrative economics of Jastrow, and the general economics of Schumacher; while, when one passes to Heidelberg, the ancient and honourable tradition of philosophy is at once apparent.

The Italian Economists.

The teaching of the Italian schools of economics has been greatly influenced by the penetration of Fascism

into the university system. This has modified the situation in two respects; it has led to the resignation of some of the economists who are hostile to the Fascist regime and who have, in consequence, left the country, while those who have remained have had to adjust their views accordingly. The outstanding economists to-day are Einaudi at Turin, Arias at Florence, and Di Stefani, Benini, and Gini at Rome. There are, of course, many others. Of the group mentioned by name Di Stefani and Gini are the most interesting. Di Stefani was the first Fascist Minister of Finance, and for long he was the most unpopular man in the country because of the reforms which he instituted, particularly in driving out the system of graft that had taken possession of the Treasury, and in his opposition to foreign loans. He is the best representative of the classical economists in Italy, and he has always followed and still does follow the development of economics in England, particularly the school of thought developed by Marshall. Gini is the mathematical and statistical economist of Italy. Though he still retains his post at the University of Rome, his main work is done at the Institute of Statistics, of which he is the head. As director of this Institute, he is responsible to no one but Mussolini and the Fascist Grand Council, both of whom are supporting him in his efforts not only to reform the Italian statistical system, but to develop it, because there is a sad lack of statistical information in Italy, and what reference books there are, are quite inadequate.

Finally, there is the distinguished Roman Catholic sociologist, Father Gratianus de Schepper a Slusa, who is Professor of Sociology at the Apollinaris University in

Rome. Father Gratianus is a Capuchin monk, and has written a huge volume on modern economics in Latin. He is very interested in problems relating to the application of Thomas Aquinas's theory of the just price to modern conditions, in the application of the Catholic theory of justice in the distribution of wealth, and in the relations between capital and labour.

The two characteristics of the Italian schools of economics are as follows: first, the contribution that the Italian economists have made to finance, and particularly to public finance; second, their very great interest in theoretical economics, particularly in value. Of more recent years they have become very interested in statistics.

Other Economists

Of the economists in other countries it is not proposed to say much. There is the Scandinavian economist, Cassel, and, in Greece, there is Professor Andréades, who is interested in finance, and who has written the history of the Bank of England in a most masterly style. Among American economists, Taussig, of Harvard, is the best-known and most widely read in Europe and in England because he has, essentially, the European point of view. Then there is Seligman, the authority on public finance and taxation, and on the economics of the instalment system. There is also Irving Fisher, America's great mathematical economist, who shares with Keynes, of Cambridge, the honour of being the foremost authority on the quantity theory of money. Finally, there is Wesley Mitchell, who has done so much work on the trade and business cycle.

The outstanding characteristic of the American economists is their pre-occupation with practical affairs and the problems of applied economics. In this they are the opposite of the Germans. This practical interest of the academic economists in the problems of trade and industry and of finance is given special point when it is realized to what extent academic economists are used by the big American banks, insurance companies, investment houses, and commercial firms. An outstanding example of this was the appointment of Professor Walter Stewart to the firm of Chase, Pomeroy and Co. For a period of time he was with the Bank of France as liaison officer and, later, with the Bank of England, though he has now returned to his old firm. Another example is that of Professor Sprague, who was for some time with the Federal Reserve Board, and who is now liaison officer with the Bank of England. In England there is not such a tendency to do these things as in America, though there are exceptions, for example, Professor Henry Clay, of Manchester University, who has been with the Bank of England now for some time.

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